The Permissibility of Indirect Environmental Taxes and Derogations Thereof in Light of the Cumulative Criteria for State Aid in Article 107(1) TFEU

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Tiivistelmä/Referat – Abstract

The aim of this dissertation is to examine when indirect environmental taxes are permissible under the rules concerning prohibited State aid in the European Union. The method applied to the dissertation is traditional legal dogmatics, which is justified by the fact that this specific field of law has been only rarely been studied in legal literature. The focus of the dissertation is the cumulative criteria for State aid. These criteria are defined in Article 107(1) in the Treaty of the Functioning of the European Union (TFEU).

This dissertation clarifies how national indirect environmental taxes are assessed under the four criteria for State aid in Article 107(1) TFEU. In order to be considered as State aid which must be subjected to the notification procedure in the Commission, an environmental tax measure must favour certain undertakings, or the production of certain goods, be financed through public resources, distort or threatens to distort competition and affect trade between Member States.

Applying the above criteria to national indirect environmental taxes proves that the assessment of the tax measures is rather strict when considering the Member States' treaty-based competence in tax matters. On the other hand, the indirect nature of the taxes as well as the acceptable aims behind them can sometimes allow them to escape the definition of State aid. In many cases, private financing of an environmental aid is preferable to an environmental tax, since the former escapes the criterion of aid being granted through state resources. Furthermore, indirect environmental taxes may have less distortive effects than other aid measures, and therefore be acceptable under Article 107(1) TFEU.

Therefore, it is recommendable that the legislators in the Member States take into consideration the strictness of the interpretation of State aid when introducing environmental tax measures. As a precaution, all such measures should be notified to the Commission. The notification can, however, be accepted by the Commission without imposing further conditions, if the tax falls outside the scope of Article 107(1) TFEU. It can therefore be wise to construct taxes so that they escape the definition of State aid control, even when the aid is being notified. The Commission's approval brings certainty to the application of the tax, which is important when considering the long-term objectives of environmental policy.

Avainsanat – Nyckelord – Keywords **state aid, subsidy, prohibited state aid, indirect taxation, VAT, excise tax, environmental taxation, green taxes, competence, EU, notification, tax policy, tax relief, cumulative criteria, standstill**

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Tiivistelmä/Referat – Abstract

Syftet med denna europarättsliga avhandling är att reda ut när indirekta miljöskatter är förenliga med Europeiska Unionens reglering beträffande statsstöd. I bakgrunden är ändamålet att klargöra för lagstiftare i medlemsstaterna vilka typer av miljöskatter de kan införa. Undersökningen är rättsdogmatisk, vilket är motiverat då ämnet tidigare behandlats rätt sparsamt i rättslitteratur. Avhandlingens fokus ligger på Artikel 107(1) i Fördraget om Europeiska Unionens Funktionssätt (FEUF), som definierar vilka typer av stöd som bör anmälas till Europeiska kommissionen innan de kan antas i en medlemsstat.

Avhandlingen klargör för hur nationella miljöskatter ter sig i ljuset av de fyra kriterierna för statsstöd som utvecklats på basis av Artikel 107(1) FEUF. För att klassas som statsstöd som bör utsättas för kommissionens anmälningsförfarande bör en miljöskatt gynna ett visst företag eller en viss produktion, finansieras genom offentliga medel, snedvrida eller hota att snedvrida konkurrensen samt påverka handeln medlemsstater emellan.

Tillämpningen av ovan nämnda kriterier på nationella indirekta miljöskatter visar att regleringen av statsstöd kan te sig strikt i förhållandet till medlemsstaternas på fördraget baserade kompetens i skattefrågor. Däremot kan skatternas indirekta natur samt dess godtagbara miljösyften i vissa fall få dem att undgå en ordagrann tolkning av kriterierna som fastställts i Artikel 107(1) FEUF. I många fall är privata avgifter att föredra framom skatter, då de kan undgå att klassas som förbjudet statsstöd. Vidare är de effekter som indirekta skatter har ofta mindre skadliga än andra stödformer i ljuset av syftet för förbudet av statsstöd.

Således kan det rekommenderas att lagstiftarna i medlemsstaterna beaktar den strikta tolkningen av statsstöd när de antar miljöskatter, och anmäler samtliga miljöskatter till kommissionen. Anmälan kan dock bli accepterad utan villkor och tillsvidare ifall skatten struktureras så att den faller utanför tillämpningsområdet för Artikel 107(1) FEUF. Detta kan anses fördelaktigt med tanke på en långsiktig och koherent miljöskattepolitik.

Avainsanat – Nyckelord – Keywords**statsstöd, statligt stöd, olagligt statsstöd, indirekt beskattning, moms, punktskatt, miljöskatt, kompetens, EU, anmälningsförfarande, skattepolitik, skattestöd, kriterier, genomförandeförbud, skattelättnad**

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Abbreviations

AG	Advocate General
ECJ	The Court of Justice of the European Union
GBER	Commission Regulation (EC) No. 800/2008 of 6 August 2008m declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation)
GC	The General Court of the European Union, previously the Court of First Instance of the European Union
OJ	Official Journal
TEU	Treaty of the European Union
TFEU	Treaty of the Functioning of the European Union
SGEI	Services of General Economic Interest
SME	Small and Medium Enterprises

1. Introduction

1.1. Background

The question of the degree to which tax measures can be considered as prohibited State aid has produced a series of case law in the European Courts. This is understandable since the subject is delicate – Member States' fiscal autonomy is being confronted with EU law. The question has also been frequently revisited by European scholars.[1] However, as Member States continuously adopt new types of tax measures and use them as tools of national policy making, the issue continues to provide for new questions. Said questions are interesting for legal scholars, but perhaps even more so for national legislators who wish to introduce new tax measures. As European economies struggle with the effects of the latest financial crisis, also citizens and media have a particular interest in how State aids, subsidies and tax burdens are being allocated.

The subject of this dissertation is therefore quite topical. More precisely, my subject is indirect environmental taxation and its permissibility in light of the general prohibition of State aid under Article 107(1) TFEU. That being said, the subject is particularly attached to three recent trends within the EU. First of all, the recent trends in taxation policy in EU Member States indicate an increasing focus on taxing consumption rather than income.[2] In other words, indirect tax measures are becoming more important as measures for financing the economies of European States. Second, taxes are increasingly being used as instruments of policy-making. This is true especially for environmental policy. Third, tax measures as a form of State aid as defined in Article 107 TFEU have become more important in comparison to direct subsidies.[3] For instance, in Finland the share of state aid granted through taxation has clearly increased during the last few years.[4]

The focus of this dissertation is on environmental taxes, and specifically *indirect* environmental taxes. This aspect is related to the first trend within taxation as mentioned above, that is, the increased taxation of consumption. As this tendency is rather recent, indirect taxes have not yet been extensively assessed in terms of State aid.[5] This

1 *See, inter alia,* Nicolaides 2001, Aldestam 2005, Micheau 2011 and Pistone 2012
2 Taxation trends in the European Union: Data for EU Member States, Iceland and Norway, Eurostat, European Union 2012, 19-20 and 27
3 Pistone 2012, 84
4 Rauhanen 2011, 4
5 Englisch 2013, 9-10; Terra 2012, 101.

dissertation shall therefore provide for insight into the specific question of State aid and indirect taxation.

The second trend referred to above, environmental policymaking by market based instruments such as taxes, relates to taxation being used as measures for attaining societal objectives. Such taxes are often referred to as Pigouvian taxes.[6] The idea of introducing Pigouvian environmental taxes is line with what macroeconomists have presented as the *'double dividend'* for society.[7] The double dividend-theory implies that the introduction of environmental taxes while simultaneously reducing the tax burden of labour without adding to the overall tax burden paves the way for a healthier physical environment and reduced unemployment.[8] As environmental protection in particular receives a considerable part of State aids granted within the EU, Pigouvian environmental taxes are particularly interesting from a State aid perspective.[9] Moreover, most environmental taxes include multiple derogations and exceptions. Such exceptions can be more or less permissible under State aid control. Therefore, while taxes are increasingly being used as instruments for pursuing environmental policy in EU Member States, tax measures such as exemptions, deferrals and tax base reductions are also used to relieve undertakings from their environmental fiscal burdens. Such a development is questionable in light of the environmental objectives of the EU and therefore worth a closer examination.

The third issue referred to above is that of modernising environmental policies by means of market based instruments. These include taxes, but also the Emissions Trading System ('ETS').[10] On a general note, promoting the use of marked based instruments in environmental policy can be seen as part of a long-lasting trend in the EU, pertinently described by *Maduro* as the spill-over effect of market integration rules into other areas of law.[11] This means that as national environmental policy is increasingly made through taxation, it will become subject to the State aid control as well, whereas direct environmental regulation might escape it. However, in contrast to the theory of a double dividend referred to above, the restrictive nature of State aid control could be seen as

6 Kingston 2012, 170-171
7 Ten Brink – Mazza 2013, 4; Kosonen 2012, 5-6; Määttä 2000, 180;
8 *See* Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tax policy in the European Union - Priorities for the years ahead, 23.5.2001, COM (2001) 260 final.
9 State Aid Scoreboard, Report on state aid granted by the EU Member States, Autumn 2012 update, 12 December 2012, COM(2012) 778 final, 11
10 Kingston 2012, 50
11 Maduro 1998, 30

obstructing the positive effects of greening the taxes rather than promoting them. In short, the intersection between EU-wide State aid control on the one hand and national environmental taxes on the other, provide for a legal sphere where several different interests seem to conflict each other. In order to further the Internal Market on the one hand and improving the environment on the other, these conflicts should be resolved in a manner which is acceptable to the Member States as well as the EU as a whole.

Finally, there is a practical issue related to the subject of this dissertation, which calling for a solution rather sooner than later. The ETS, which produced high hopes for the reduction of greenhouse gas emissions, has encountered serious problems due to the decline in prices of energy and due to the European Parliament rejecting a recent amendment to the ETS seeking to intensify its impact.[12] The effectiveness of the ETS as a marked based instrument, capable of reaching the environmental goals the EU has committed itself to, has become questionable. The most credible marked based instrument left to use is therefore environmental taxation, the adoption of which lies largely on the Member States. For this reason, national environmental tax measures deserve a thorough examination as to their acceptability under the provisions of State aid control.

1.2. Aim and Questions at Issue

The underlying theme of this dissertation is to look into what types of environmental taxes Member States can adopt while being subjected to State aid control. Answering this question can help national legislators develop effective environmental tax policies while complying with the requirements of State aid control. The more precise aim of this dissertation is to examine the intersection between national environmental taxation and the cumulative criteria for State aid as laid down in Article 107(1) TFEU. As mentioned above, this specific field of environmental protection, indirect tax policy and State aid control, has not been given too much attention in neither case law of the European Institutions or legal European literature. Despite their fairly important economic effects, in general, indirect taxes have not been as actively assessed in terms of State aid as direct taxes.[13] Environmental taxes are mostly composed of indirect taxes. Environmental taxes[14],

12 European Commission, Press Release, MEMO/13/343, 16 April 2013
13 Englisch 2013, 9-10; Terra 2012, 101
14 *See inter alia* Määttä 1997; 1999; 2000; 2006; Engle 1999; Martikainen – Virén 2006; Bartelings et. al. 2006; Fullerton et. al. 2010; Kosonen 2012; Terra – Wattel 2012; Ten Brink – Mazza 2013

environmental State aid[15] and fiscal State aid[16] have generally been studied extensively, but only scarcely from a perspective which combines the three.[17]

Therefore I shall study the intersection of these three fields of law. My assessment is constructed so as to identify the critical issues that arise particularly in relation to derogatory tax measures. This I shall do from a rather pragmatic angle, using practical examples of legislation in Member States to illustrate the critical points. Further, when identifying the specific issues related to environmental taxes when subjected to State aid control, I shall assess these issues in light of the main objectives connected with both State aid control and environmental policymaking through taxation. Finally, I shall attempt to draw some general conclusions on how environmental taxes should be designed in Member States with due regard to State aid control. Put concisely, my two main research questions are the following:

1) What types of environmental taxes and derogations thereof are permissible in light of the criteria for forbidden State aid in Article 107(1) TFEU?

2) How are the objectives behind State aid control and environmental policy in the EU taken into consideration in the above interpretation of environmental taxes?

Moreover, based on the analysis of the above questions, I shall attempt to answer the following question by identifying a few practical guidelines which could be useful for national legislators:

3) How should national legislators take State aid control into consideration when adopting national fiscal measures to pursue environmental policy?

1.3. Structure and Delimitations

Environmental aims are and should be taken into account in assessing the compatibility of tax measures with the provision concerning State aid control. However, there are uncertainties as to where in the process of State aid control the environmental concerns should matter.[18] The topic of this dissertation is limited to the question of when environmental taxes are considered as State aid within the meaning of Article 107(1)

15 *See inter alia* Siikavirta 2007; Kingston 2012
16 *See inter alia* Aldestam 2005; Micheau 2011; Quigley 2012; Terra 2012; Englisch 2013
17 *See* Kingston 2012, 393ff
18 Kingston 2012, 380

TFEU. Tax measures meeting the criteria of said Article must be notified to the Commission prior to adoption. Despite amounting to State aid under said article, environmental taxes can be permitted, as long as they have been properly notified to the Commission as required in Article 108(3) TFEU. The Commission may declare an aid compatible with the Internal Market if the aid falls under the scope of the exemptions in the second and third paragraphs of Article 107.

However, the focus of the present dissertation is on the need to notify a tax measure in the first place, not on whether measures which have been notified can be declared permissible by the Commission. The reason for this is twofold. The first reason relates to the basis of the discussion on the feasibility of environmental taxation as a means of making environmental policy, that is, whether it is a *suitable* and *efficient* policy instrument. The notification procedure pursuant to Article 108(3) TFEU may have been rendered smoother, but it does add to the administrative burden of national policy making hence making it less efficient. Moreover, the requirement to notify tax measures it is not entirely in line with the fact that taxation rests principally within the competence of the Member States.[19] Consequently the duty to ask for an approval from the Commission when adopting a tax measure could be seen as a something that hinders the exercise of national fiscal autonomy.

The second reason for focusing on Article 107(1) is that the types of environmental aid which the Commission may accept relying on the provisions of Article 107(2) and 107(3) TFEU have been rather thoroughly defined in the Environmental Aid Guidelines.[20]. Thus there are in my mind fewer academically interesting issues related to aid measures which are declared compatible with the Internal Market upon notification. Moreover, the possibilities of exemptions are relatively limited, preconditioned and only accepted for limited periods of time.[21] The notification procedure also requires for a significant administrative effort from the Member States. Therefore, I shall limit the examination of these exemptions provided for in the Treaty to a rather superficial review.[22]

19 See Chapter 2.1
20 Community guidelines on State aid for environmental protection, OJ C 82, 1 April 2008, p. 1-33 (hereinafter 'Environmental Aid Guidelines')
21 See for a similar justification of delimiting a study of State aids to Article 107(1) TFEU in *Aldestam* 2005, 18-19.
22 See Chapter 5.5

As to the structure of the dissertation I shall first introduce the subject by briefly outlining the taxation policy and environmental taxation policy as well as their respective objectives within the EU. Second, I shall analyse the Commissions documentation and State aid case law concerning taxation in order to establish how the four cumulative criteria for defining prohibited state aid should be interpreted regarding fiscal State aid. Third, I shall analyse the criteria and their interpretation in light of environmental taxes. In the final part of this dissertation, the results of the assessment of environmental taxes shall be summarized and reviewed in light of the objectives of State aid control and of environmental protection in order to establish general recommendations for adopting environmental taxes.

1.4. Method and Materials

From the outset, my approach on the subject in this dissertation is that of legal dogmatics and systematising. A systemic approach to European law includes interpretation based on contextualising and harmonising, precedent rulings, legal analogy, conceptual and logical arguments, as well as arguments emphasising general principles of law.[23]

The theoretical discussion in this dissertation is largely based on academic articles and it will appear in connection with each separate issue that arises when systematising the rules on State aid in the context of environmental taxes. This is a particularly suitable way of answering the first research question of this dissertation, because the purpose is to collect all relevant legal issues which reside in the cross section of the different fields of law addressed. Moreover, a systemic and dogmatic approach is justified as the subject has not yet been addressed in academic writing. A less generalist point of view could narrow the discussion too much as well as colour the dissertation by my subjective initial expectations. Nevertheless, it must be acknowledged initial expectations can never be entirely excluded, as the author of legal dogmatics simultaneously forms part of the legal system which he or she is studying.[24] However, as my thesis provides for an introductory discussion on the subject, I consciously attempt to apply an objective approach. In short, my method is much in line with traditional legal doctrine, applied on the context of EU legislation, of course.

As the second research question focuses on the objectives of the legal fields examined, my approach also includes a teleological element. In order to establish the objectives of the legislation, I shall rely on the prime objectives of the Treaties, such as establishing a

23 Raitio 2010, 185
24 See Tuori 2000, 161-162

functioning Internal Market. Moreover, I shall cover specifically environmental objectives, such as they have been expressed by the Commission and other EU institutions.[25] The value of this approach is that it can reveal which objectives and which principles are dominant in a situation where two or several legal fields conflict. For instance, while environmental factors are increasingly taken into consideration in introducing taxes, the aforementioned legalistic-positivist approach of tax law limits the use of environmental arguments laws are in conflict or fail to provide an answer to a practical issue. The general principles of tax law adjust slowly to changes in society,[26] whereas the ECJ's practice constantly develops and refines legal principles with different fields of EU law, State aid law included.[27] Especially tax cases where national and EU laws conflict have demonstrated that a straightforward legalistic approach can be insufficient.[28] Moreover, certain hierarchies of principles and values can be inherent to the legal culture and its norms so that some are given more value than others in a confliction situation.[29] It is therefore interesting to see how conflicts between environmental objectives and State aid control can be consolidated with regard to their differing objectives.

Moreover, the subject matter of the dissertation, European tax law, has influenced the choice of method. In general, a dogmatics-based approach has been considered sufficient because of the traditionally legalistic principle within tax law.[30] However, legal research within the field of taxation has also been criticised for being too concentrated on dogmatics, while neglecting the societal and political connections which are intrinsically linked to taxes.[31] Therefore, my intention is to incorporate an *instrumental* approach[32] to the examination of environmental tax law, particularly in connection with the third research question. In other words, I shall attempt to extract a few recommendations and guidelines on how to make good environmental tax policy at a national level when considering State aid control. Where applicable, I shall also refer to more general features of what has been considered as better and more efficient regulation.[33]

25 See Raitio 2010, 185-186 on teleological interpretation of EU law
26 Wikström 2008, 13
27 See for a summary of principles adopted by the ECJ, Raitio 2010, 248-250.
28 Wikström 2005, 274
29 *See* Tuori 2000, 199
30 Wikström 2005, 273
31 Urpilainen 2012, 38-39
32 Wikström 2011, 88
33 See on the concept of better regulation *e.g*. Tala 2010

As to the materials used in this dissertation, the documents and research published for the account and by the Commission function as a point of departure. The Commission plays an important role in the State aid control system in the EU, as it alone can approve of state aid measures upon Member States' notifications of new aid measures, or take action to against non-notified aid.[34] Therefore, the Commission's publications and decisions are of essential importance for the analysis of State aid control, and are thus frequently referred to in this dissertation.[35] It is not uncommon, however, that the Commission's decisions are re-examined and sometimes overruled by the European Courts. Consequently the contribution of the Courts' case law has contributed to the interpretation of State aid rules has been significant. As the jurisprudence is integrated in the Commission's guidelines and other publications on a regular basis, an important part of the dissertation is based on the cases of the European Courts even when the essential content of those cases has subsequently been inserted into Commission Guidelines, for instance. Meanwhile, the ECJ and the GC every so often rely on the Commission's Guidelines in their interpretation. This being the case, I refer to the Commission's publications and the Courts' jurisprudence alternately, without establishing a clear hierarchy between the two except for when the Commission's decisions have clearly been overruled by the Courts. When discussing the more general policy objectives and principles behind State aid regulation, the Commissions policy documents are naturally the most essential references.

In addition, I shall refer to current environmental taxes in a few Member States, notably in Finland and in France in order to provide for a more practical insight into the subject. My aim is, however, not to use comparative methods other than occasionally. Since the main interest in the subject matter is the relation between national law and EU law, comparing the national systems with each other would not necessarily bring much to the examination of the issue.

34 Article 108 TFEU. See case C-173/73 *Italy v Commission* [1974] ECR 709 concerning the Commissions powers as regards non-notified aid.
35 Aldestam 2005, 30

2. Taxation Policy in the EU

2.1. The Competence of the EU and the Member States Concerning Taxation

In the following I shall briefly present the basis for European tax integration by presenting the distribution of competences in tax issues between the EU and the Member States respectively. The question of competence is particularly relevant to the subject to this dissertation since State aid control restricts Member States' freedom to pursue their own tax policies. Furthermore, I shall present the legislative tools that have been introduced by the EU in order to promote environmental aims by means of taxation, in other words the existing measures for the positive harmonisation of environmental taxes. This shall provide for the outset of the analysis of the negative harmonisation of environmental taxes through the prohibition of State aid.

In the TFEU, the Member States have given the EU competence to legislate on taxation issues on three different levels, either by giving

(1) exclusive competence to the EU,[36]
(2) shared competence, where the Member States remain free to legislate as long as no EU legislation has been passed[37] or
(3) coordinating competence,[38] where the EU may legislate on issues of coordination and supporting of the legislation which is in the competence of the Member States.[39]

As to the definition of competences in taxation issues, the foremost principle remains that Member States have the power to decide upon their national taxation systems. Nevertheless, due to the EU's original nature as a customs union, all customs tariffs are the *exclusive competence* of the EU.[40] Member States can thus not apply their own duties or charges of equivalent effect to products from other Member States or third countries.[41]

Apart from customs, the fields of taxation which have been developed the furthest in terms of harmonisation on an EU level are *indirect taxes* such as excise taxes and value added tax, the legal basis of which is established in Article 113 TFEU. Said Article requires that

[36] *See* Article 3(a) TFEU
[37] *See* Article 4 TFEU
[38] *See* Article 6 TFEU
[39] Terra – Wattel 2012, 9
[40] *See* Article 28 TFEU and 3(a) TFEU
[41] Terra – Wattel 2012, 10

indirect taxation be harmonised in order to ensure the establishment and functioning of the Internal Market. Despite this quite manifest plea for the adoption of EU legislation in the field of indirect taxation, the obligation to do so in practice still lies on the Member States, since proposals based on Article 113 TFEU must be adopted by *unanimity* in the Council.[42] That being said, the EU and Member States exercise *shared competence* in the field of indirect taxation.

As a consequence of this, the Member States maintain a certain margin of discretion when it comes to indirect taxes. On the one hand, some areas of indirect taxes have not been harmonised at all, and thus allow for Member State to impose their own taxes as long as they do not breach any other provisions of EU law.[43] On the other hand, as with most of the legal instruments at EU level, the harmonisation of indirect taxes is often based on minimum harmonisation. Member States are thus allowed to apply a stricter tax rate or scheme at a national level. This discretion must, similarly as in connection with non-harmonised taxes, be exercised in compliance with EU law. In other words, Member States may in principle apply higher tax rates than those indicated in a directive, for instance Directive 2003/96/EC[44] on the taxation of energy and electricity, but they must do so in compliance with all other provisions of EU law, including the provisions concerning State aid. Thus the Member States' competence is circumscribed by how the ECJ interprets conflicts between national tax measures and State aid provisions. During the last ten years, indirect taxes have become increasingly important in the Commissions control of State aid measures, amounting to one third of the cases relating to fiscal aids in 2010/11.[45]

As regards excise taxes, which are the main focus of this dissertation, typical excises to be harmonised on an EU level are those imposed on liquid fuels, alcohol and tobacco products, which have a set minimum tax rate defined in the relevant directives. Since the Adoption of Directive 2003/96/EC the scope of application of energy tax has been broadened to not only liquid fuels, but nearly all energy products.[46] The taxes based on this directive are classified as environmental excise taxes for the purposes of this dissertation.

[42] Weber 2010, 2
[43] For instance vehicle taxation has not been harmonised within the EU, but it has been subject to many court cases due to infringements of EU law, particularly Article 110 concerning discriminatory and protective product taxation. See for that effect Terra – Wattel 2012, p. 13-14.
[44] Council Directive 2003/96/EC
[45] Englisch 2013, 10
[46] With the exception of *e.g.* peth

Direct taxes remain largely within the *sole discretion* of the Member States,[47] although some directives on direct taxation have been adopted by unanimity in the Counsel.[48] Those directives are based on Article 115 TFEU concerning legislation that directly affects the '*establishment or functioning of the internal market*'.[49] Moreover, the regulation concerning the European Economic Interest Grouping including a provision concerning the taxation thereof has been adopted on the basis of Article 352 TFEU, which permits any appropriate measures in realising Treaty objectives, when adopted with unanimity in the Council.[50] In the field of direct taxation, taxes that relate directly to the internal market or to a more limited extent 'appropriate measures' thus fall within the competence of the EU, albeit that they need unanimity in the Council to be adopted. Other direct taxes fall within the exclusive competence of Member States. As stated by the ECJ on numerous occasions, the Member States must exercise their competence concerning direct taxes in compliance with EU law,[51] thereby including Article 107 TFEU concerning State aid.

As a consequence of both indirect and direct taxes being dependent on unanimous decisions of the Council, tax issues are still predominantly within the power of the Member States. However, certain important exceptions do apply, among those the rules concerning State aid. The Commission has the sole competence (in addition to the ECJ, naturally) to decide whether a tax measure is compatible with the rules concerning State aid, and any such national tax measure must be approved by the Commission before implementation. Naturally, Member States' power to tax is constrained by limits produced by other provisions EU law as well, in particular the rules concerning free movement within the EU and the prohibition of distortive internal taxation provided for in Article 110 TFEU.[52] Nevertheless, State aid control remains one of the most restrictive limitations due to the requirement of prior control by the Commission.

[47] Alkio 2010, 67
[48] Currently four directives have been adopted, among them the *Parent Subsidiary Directive (*Council Directive 2003/123/EC).
[49] Weber 2010, 2
[50] Article 40 of Council Regulation (EEC) No 2137/85.
[51] Concerning direct taxes, see *e.g.* case C-387/11 *Commission v Belgium,* [2012] (not yet reported)
[52] See for recent case law, case C-371/10 *National Grid Indus* [2011] (not yet reported) concerning freedom of establishment.

2.2. Environmental Taxes in the EU

2.2.1. Legal Basis

Despite the EU's origins being that of an economic project, environmental objectives have been present in the Treaties already since 1986,[53] with the Commission introducing its first proposal on an environmental tax in 1992, basing the proposal on Articles 113 TFEU and 192 TFEU.[54] On a general level, the EU's environmental policy is based on Article 3 TEU according to which the EU shall promote a high level of protection and improvement of the environment. Moreover, articles 191 and 192 TFEU define the objectives and principles of the environmental policies of the EU.

One of the principles brought up in Article 192 is the Polluter Pays principle ('PPP'), which merits a short definition as it shall be returned to in the assessment of environmental taxes as prohibited State aid. Described in broad terms the PPP signifies that the person who causes the environmental damage should also be liable to removing or redeeming it.[55] In economic terms the notion is closely linked to that of negative externalities. Negative externalities imply that not all economic effects of a production process are included in the costs of producing it, such as costs deriving from the environmental harm caused by production, the value of which the producer would normally not take into account.[56] In the end, this means that someone else – often society – has to pay for the remediation of the harm caused to the environment. According to the Commission, one way of implementing the PPP, and thereby avoiding the problem of negative environmental externalities, is using market-based instruments to include the negative externalities in the production costs. In the absence of legislation on the EU level, the Commission recommends that Member States adopt national environmental taxes in order to implement the PPP in their national environmental policies.[57]

The PPP is also a central notion in the Commission's Green Paper on the introduction of Market Based Instruments for environment policy in the EU. The paper promotes the view according to which measures such as taxes, charges and the Emissions Trading Scheme

[53] Terra – Wattel 2012, 536
[54] Proposal for a Council Directive Introducing a Tax on Carbon Dioxide Emissions and Energy, OJ C 196, 3.8.1992, p. 1–8
[55] Määttä 1997, 19-20
[56] Siikavirta 2007, 51; Määttä 2009, 21; OECD 2010, 21-22; Quigley 2009, 271. For an in depth analysis of control of externalities through taxation, see Baumol 1972, 307*ff.*
[57] Environmental Aid Guidelines, paras 8-10 and 21

(ETS) are the most efficient way of enforcing environmental objectives.[58] As mentioned in the introduction to this dissertation, the ETS has not yet achieved the expected effects, which is why environmental taxes may play increasing role in future environmental policies of EU Member States.

2.2.2. Defining Environmental Taxes

The notion of an environmental tax has been defined by the Commission as '*a tax whose specific tax base has a clear negative effect on the environment or which seeks to tax certain activities, goods or services so that the environmental costs may be included in their prince and/or so that producers and consumers are oriented towards activities which better respect the environment*'.[59] As can be read from the definition, the Commissions' view of the notion '*environmental tax*' is closely related to including negative externalities in production prices and thus PPP, which were discussed above. Environmental subsidies, including tax relief, are a typical a typical instrument of correcting market failures such as the omission of environmental costs incurred on society.[60] In addition, environmental taxes incentivise undertakings and private persons to consume more environmentally friendly products and services. The definition therefore also includes for instance waste taxes, packaging taxes and charges for the use of water supplies.[61]

However, normally environmental taxes which meet the description of the Commission are not applied uniformly, but encompass derogations and exemptions, justified by other policies. Such policies include maintaining competitiveness, preventing tax evasion, as well as promoting social and regional policy objectives. Derogations which aim at maintaining the competitiveness of undertakings subject to the environmental tax have been referred to as '*competitiveness aid*' by the Commission.[62] This type of tax relief has also been referred to as '*harmful subsidies*' as regards the environment.[63] This latter type of tax measures, aimed at reducing the burden caused by taxes with environmental aims, is more controversial as regards State aid than strictly cost-internalising tax measures. Such derogatory measures are therefore in the focus of this dissertation.

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[58] Green paper on market-based instruments for environment and related policy purposes, COM(2007) 140 final (28 March 2007), 2
[59] Environmental Aid Guidelines, para. 70(14)
[60] De Cecco 2013, 41
[61] *See* Green paper on market-based instruments for environment and related policy purposes, COM(2007) 140 final (28 March 2007), 11-12
[62] Consultation paper on Environmental and Energy Aid Guidelines 2014-2020, 16
[63] Withana et.al. 2012, 3

However, when it comes to said derogations from environmental taxes, it may be worth noting already at this stage that such derogations are often related to other important policy objectives. Such policy objectives include for instance promoting economic activity and social wellbeing.[64] Such socially justified derogations may be particularly hard to assess in light of environmental objectives. In principle, any reduction of an environmental tax could be considered a '*harmful subsidy*' which should be prohibited. Likewise, from the perspective of an average tax payer, for instance the reduction of energy taxes for energy intensive businesses seems rather contrary to the purpose of the tax.[65] However, the border-crossing nature of many pollutants can make reductions from an environmental tax necessary – otherwise the polluting activity might be moved abroad, with the dissatisfying result of the amount of pollution remaining unaffected by the tax. Consequently, derogations from environmental taxes are often granted due to economic and social concerns.

Derogations from tax measures may also be necessary when introducing new taxes in order to allow private parties to adjust to new environmental requirements. Gradually, these derogations can be removed so as to allow for a transition to a greener economy. The objective of moving towards a greener economy is line with what macroeconomists have presented as the *'double dividend'* for society.[66] The double dividend-theory implies that the introduction of environmental taxes while simultaneously reducing the tax burden of labour without adding to the overall tax burden paves the way for a healthier physical environment and reduced unemployment.[67] From an administrative point of view, environmental taxes are also perceived as a convenient way of incentivising the introduction of environmentally friendlier behaviour.[68] Taxes also provide for a less rigid control mechanism than categorical authorisations and prohibitions.[69] In other words,

[64] See Article 3(3) TEU which includes all of these elements. See also Urpilainen 2012, 29-31 who points out that the Treaties nowadays reflect a much more diverse set of objectives than before, including not only economic, but also social and environmental goals, albeit those objectives not being too clearly defined.
[65] Määttä 2000, 178-179
[66] Ten Brink – Mazza 2013, 4; Kosonen 2012, 5-6; Määttä 2000, 180;
[67] *See* Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tax policy in the European Union - Priorities for the years ahead, 23.5.2001, COM (2001) 260 final.
[68] Kingston 2012, 56
[69] Pesonen 2007, 403

greening the taxation might lead to a 'win-win'-situation for society without burdening companies with extensive administrative procedures.[70]

Furthermore, researchers have pointed out that the definition of an environmental tax allows for a certain flexibility, which makes it a notion susceptible to ambiguity and even bias.[71] This is true not only in situations such as the ones described above, where states apply derogative schemes from environmental taxes based on other policy objectives. In addition, many taxes which truly do confer tax advantages on environmentally friendly activities will also confer advantages with regard to other policy objectives, such as fiscal and allocative ones.[72] Unsurprisingly, Member State might also use environmental aims as the outspoken objectives of a tax measure, while in reality pursuing taxes based on wholly different. This was the case in Sardinia, where a stopover tax on air traffic was levied only on operators domiciled outside Sardinia, despite the outspoken objectives of the tax being the protection of the Sardinian environment and coastal landscape heritage. The ECJ concluded that in light of the environmental objectives, domestic and non-domestic persons making stopovers on Sardinia caused equally harmful effects on the environment, and were thus in an objectively comparable situation, fulfilling the criteria of selectivity. The measure was considered to constitute both prohibited state aid as well as a non-justified breach of the freedom to provide services.[73]

2.2.3. Environmental Taxes in the Member States

The Commission has identified three different categories of environmental within the EU. Those categories are (a) *excise taxes*, (b) *VAT* and (c) *specific levies*.[74] The tax rates of these taxes very considerably between Member States, especially when it comes to excises, despite excise taxes being harmonised at a minimum level for many products. Many

[70] One study on costs and benefits associated with the use of incentives promoting the use of energy-efficient appliances showed that on a general level the use of energy taxes was the most efficient way of reaching energy efficiency in the EU. The results also indicated that tax credits directly aimed at the consumer were more cost effective than those aimed at manufacturers (See Terra – Wattel 2012, 541-542)
[71] Määttä 1997, 38-39
[72] Green paper on market-based instruments for environment and related policy purposes, COM(2007) 140 final, 28 March 2007, 15
[73] *See* case C-169/08 *Regione Sardegna*, [2009], ECR -10821, paras 41 and 63-64
[74] Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tax policy in the European Union - Priorities for the years ahead, 23.5.2001, COM (2001) 260 final, 12

Member States also apply additional excise taxes due to environmental considerations.[75] Member States have introduced a range of different environmental taxes such as motor vehicle registration taxes, water and waste charges, carbon tax and taxes on specific pollutants and pesticides.[76] Specific levies have not been harmonised at a general level at all in the EU, however, some national environmental levies have been harmonised 'negatively' by ECJ rulings, particularly as to their compatibility with Treaty provisions.

Concerning the first category identified by the Commission, *(a) environmental excise taxes*, Directive 2003/96/EC harmonises the minimum tax rates of energy products and electricity in the Member States.[77] The current objectives of the directive include improving the environment, whereas traditionally the objectives of energy taxation in the EU have been energy efficiency, security of supply and competitiveness.[78] The minimum levels of taxation of heating and motor fuels and of electricity are defined in the Annexes of Directive 2003/96/EC, and due to the principle of substitution they also apply to equivalent liquid fuels which are not mentioned in the annexes.[79] This clearly limits the Member States possibilities to reduce environmental excises as part of creating an attractive fiscal environment. By virtue of the directive, indirect taxation, with the exception of VAT, is in general prohibited for mineral oils used for purposes *other* than motor fuels or heating fuels. Another example is fuel for commercial air traffic, which must be exempt from excise tax.[80] The mandatory exemptions also apply to other taxes which would result in a similar tax burden as the prohibited tax measure, even if such other

[75] Compare with the first draft framework directive on excise duties which was never adopted, and which required for the abolition of all other excise taxes than those prescribed by the directive, *see* the Proposal for a Directive on excise duties and indirect taxes other than VAT, directly or indirectly affecting the consumption of products, OJ C 43, 29.4.1972, p. 23

[76] Kingston 2012, 59-60

[77] The scope of the previous directive on the subject was limited to mineral oils, whereas the current directive extends to all energy products including coal, natural gas and electricity. A proposal amending the directive has been presented by the Commission, including a new way of calculating the mimimum tax for each type of fuel, see Proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity, COM(2011) 169/3

[78] Green paper on market-based instruments for environment and related policy purposes, COM(2007) 140 final (28 March 2007), 7

[79] Finnish Fuel Tax Act 2a §; Government Bill HE 147/2010, 14; Kurkioja – Sneck 2012, 72; Juanto – Saukko 2012, 264-265

[80] Article 14(1)(b) of Council Directive 2003/96/EC

taxes would not be not harmonised on an EU level.[81] However, in most respects the directive does allow for national environmental excises on the excise goods[82] as well as national levies on other goods than those which have been harmonised.[83] Moreover, Member States are allowed to differentiate the tax rates provided that they do not breach EU law, including the provisions concerning State aid.[84] Consequently, the field of national environmental excises remains heterogeneous.

The second category *(b)* in the classification of Commission, the *VAT*[85], has been most affected by EU tax legislation. Member States have been able to make derogations from the VAT level on environmental grounds, as certain aspects of VAT remain within the discretion of the Member States.[86] However, the use of environmental VAT rates is restricted by the fact that the amount and extent of derogative VAT rates is limited.[87] The case law on the subject is therefore scarce, but it includes *inter alia* the Portuguese reduced VAT for the production and use of renewable energy resources.[88] Although national environmentally based variations of VAT rates have not been subject to State aid control measures too often, it does not mean that VAT would be uncomplicated in terms of State aid. Instead, it seems that national differentiations of the VAT scheme are still something of an unmapped territory, and not only when it comes to environmentally justified variations. This is illustrated by the results of a study conducted on behalf of the Commission. The study showed an existing gap in all Member States between VAT receipts which had actually been accrued and the expected VAT. The gap ranged from 5 % to 30 % depending on the country.[89] A part of this shortage of VAT is completely legitimate, whereas a part of it might be the result of derogations and reduced rates, which are not in line with the provisions on State aid.[90]

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[81] Government Bill HE 147/2010 vp, 6. See *e.g.* case C-346/97 *Braathens* [1999] ECR I-3419, in which the ECJ ruled that also a tax levied on domestic commercial aviation being calculated by reference to data on fuel consumption and emissions of hydrocarbons was incompatible with the exemption of excise duty on mineral oils for flight traffic as stipulated in Directive 92/12/EC. For a more recent case on similar issues, see case C-94/10 *Danfoss* [2011] not yet reported, paras 8-10 and case C-437/01 *Commission v Italy*, [2003] ECR I-9861.
[82] Article 1(2) of Council Directive 2008/118/EC
[83] Article 1(3) of Council Directive 2008/118/EC
[84] Kurkioja – Sneck 2012, 19
[85] Council Directive 2006/112/EC
[86] Englisch 2011, 4
[87] Terra – Wattel 2012, 538
[88] Report on the use of differential VAT rates to promote changes in consumption and innovation 2008, 6
[89] Study to quantify and analyse the VAT gap in the EU-25 Member States, Report 21 September 2009, DG Taxation and Customs Union, 9
[90] Terra 2012, 111

Furthermore, the third category identified by the Commission, *(c) specific levies*, has not been harmonised by EU legislation. The Commission has attempted to harmonise certain environmental levies through positive harmonisation, but without success.[91] As positive harmonisation has not lead to any results, the ECJ has pushed for the negative harmonisation of environmental levies in cases concerning their compatibility with Treaty provisions. Motor vehicle registration taxes provide for a good example of a field of non-harmonised specific levies which have given rise to a considerable amount of cases before the Commission and the ECJ.[92] As negative harmonisation though case law is naturally more fragmented than what would be the case with directives for instance, registration taxes for motor vehicles still vary considerably across the EU.[93]

[91] *See* Proposal for a Council Directive on passenger car related taxes, COM(2005) 261 final, 5 July 2005. See also the Commission Communication clarifying the EU rules which are to be taken into consideration when applying taxes on car registration and circulation, COM(2012) 756 final, 14 December 2012.
[92] Terra – Wattel 2012, 543
[93] with the exception of the mandatory exemption for temporary imports of mainly consumer cars, as prescribed for in Council Directive 83/182/EEC

3. The Objectives of State Aid Control and Green Taxes

3.1. An Internal Market without Harmful Tax Competition

Originally, the essence of the purpose of State aid control has been the prevention of distortion of competition in the internal market deriving from state intervention.[94] Further, its purpose is to prevent protectionism on the internal market. Protectionist measures are particularly harmful to the internal market as they prohibit products, services or capital from some Member States from entering the markets of others.[95]

When it comes to taxation, State aid control can also be considered to be aimed at *preventing harmful tax competition*,[96] although this approach on State aid objectives has also been criticised. According to some researchers, the aim of Article 107(1) TFEU is not to create a level playing field (in terms of taxation) for Member States competing to attract business investments, but to ensure undistorted competition between competing undertakings.[97] Following this reasoning, State aid control can only target asymmetric regulation *within* individual Member States, but not strategic regulatory differentiation *among* them, because it does not apply tax measures that benefit all undertakings within one Member State equally.[98] This view has been defended by Advocate General Jääskinen by saying that' *harmful […] tax competition clearly does not fall within the mechanism for controlling State aid*'.[99]

As the main focus of this dissertation is *indirect* environmental taxation, it is worthwhile to note that differences in turnover taxes do not entail an equal risk of harmful tax competition as do direct taxes, with the exception of areas with extensive consumer mobility.[100] However, tax competition in the field of environmental taxes can be of a passive nature, meaning that Member States abstain from raising energy taxes as the expect other Member States to freeze their tax rates as well.[101] Therefore, environmental tax subsidies can amount to detrimental competition in the EU regardless. Restricting selective

[94] Case 173/*73 Italy v Commission* [1974] ECR 709, para. 13. See also Quigley 2009, 54.
[95] Case C-143/99 *Adria-Wien* [2001] ECR I-8365, para. 22. See also Ojala 2011, 559 and Englisch 2013, 15
[96] López 2010, 817; Pinto 2003, 192
[97] Englisch 2013, 17; Siikavirta 2007, 120; See also *de Cecco* 2013, 128-132 for further discussion on State aid and harmful tax competition. *De Cecco* also points out that the Treaty makes a clear distrinction between State aid control and harmonisation of laws, as the two are presented in separate chapters (ibid., 96).
[98] De Cecco 2013, 41
[99] Opinion of AG Jääskinen of 7 April 2011 in joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, para.134
[100] Kessing 2008, 2-3; Pastukhov 2007, 54f; Määttä 2000, 176-177
[101] Määttä 2000, 174-175

tax subsidies on a national level will thus also help protecting EU Member States from harmful tax competition within the EU.[102]

Furthermore, there is at least one more objective that has been present in the Commissions decisions on aid measures notified under Article 108(3) TFEU. According to the Commission, State aid control has an important role in enhancing environmental sustainability in the European Union in accordance with the Europe 2020-strategy.[103] State aid measures can be permitted under Article 107(3)(c) TFEU, provided that they are compatible with provisions of the Environmental Aid Guidelines.[104] Fiscal aid which can be permitted due to environmental concerns is further discussed in Chapter 6.5.

Summing it up, the main objectives of State aid control are preventing
a) the distortion of competition,
b) protectionist measures aimed at other Member States and
c) harmful tax competition between Member States,
although the legitimacy last objective is one that has been contested in legal doctrine. Moreover, environmental objectives are specifically taken into account when assessing the permissibility of notified aid measures.

3.2. Internalising Environmental Costs by Means of Taxation

Environmental taxes have been introduced both in national tax systems and on en EU level as a consequence of the current trends in environmental policy. In general, environmental policies, especially in the EU, are focused on promoting the introduction of so called market based instruments to be used on top of more traditional legalistic and administrative instruments.[105] The change of focus from direct regulation to market based instruments is considered to have its origins in the Law and Economics movement. More generally, the market based instruments have their origin in the neoliberal ideologies of the 1980's.[106] Promoting the introduction of environmental taxes coincides with the idea of adjusting the tax burden in society in a more profound way by reducing the tax burden of labour, since it has been considered to slow down growth. Instead, one should increase the tax burden of

[102] De Cecco 2013, 41-42. See also the Commission's First Report on Competition Policy (1972), para. 134 and Commission's Fourth Report on Competition Policy (1974), para. 148
[103] Commission Staff Working Paper Accompanying the Report from the Commission on Competition Policy 2011, SWD/2012/0141 final, 6-8. See also Green paper on market-based instruments for environment and related policy purposes, COM(2007) 140 final (28 March 2007), note 3
[104] Environmental Aid Guidelines, paras 6-12 and Quigley 2009, 271
[105] Pesonen 2007, 401
[106] Kingston 2012, 51

activities that are harmful for the environment.[107] The tendency to introduce environmental taxes or other market based instruments within the field of environmental policy has been adopted at a national level as well, albeit in differing extents in different Member States.

The reasons for promoting market based instruments such as taxes are varied. It is characterising, however, for environmental taxes to take the form of Pigouvian taxes. Pigouvian taxation means that market actors are forced to take into account all relevant costs connected to their activities, much in line with the PPP described above in Chapter 2.2.1.[108] Moreover, tax measures can be connected to fiscal aims, that is, collection of revenues to the Member State. However, due to the incentivising nature of Pigouvian taxes, the actual revenue of an environmental tax is supposed to be reduced if and when the tax functions as desired. Fiscal aims are therefore normally less important than the aim of improving of the environment.[109] Environmental taxes are often purposefully constructed to be fiscally neutral.[110] Fiscally neutral environmental taxes are also recommended by the Commission.[111]

In addition to the objective of internalising environmental externalities into the cost structure of undertakings, the objectives of freedom of choice for undertakings and consumers is often mentioned both in EU and OECD publications. The same can be said for the objective of simplifying regulation to reduce the administrative costs of environmental protection.[112] The idea is to reduce administrative costs so that sustainable growth can be encouraged without risking detrimental effects on the overall competitiveness of undertakings.[113] Moreover, many environmental taxes encompass derogations and exemptions precisely in order to maintain the competitiveness of undertakings producing substantive environmental externalities.

Introducing market based instruments into European environmental policy has also been the focus of the Commissions policy work in the field of the environment. In a way the

[107] Communication from the Commission, Europe 2020, A strategy for smart, sustainable and inclusive growth, COM(2010) 2020 final, 3 march 2010, 16 and 26. See also Europe 2020 Strategy – Finland's National Programme, Spring 2013, 10c/2013, 42.
[108] Kingston 2012, 56
[109] Määttä 1997, 354-355
[110] Kingston 2012, 56. See also *e.g.* Government Bill HE 91/2012 vp, 3 where it is specifically stated that the purpose of the amendment of the tax regime is to increase environmentally friendly activities and not to collect tax revenue, which is why the amendments are carried out in a fiscally neutral manner.
[111] Green paper on market-based instruments for environment and related policy purposes, COM(2007) 140 final (28 March 2007), 5
[112] Pesonen 2007, 401; Tala 2010, 804
[113] Kingston 2012, 51

national tendency of adopting marked based measures is both the cause and the consequence of similar measures being adopted in the EU. Making environmental policy with marked based instruments instead of direct regulation results in Treaty provisions becoming applicable on such fields of environmental policy, where the EU would not have had competence if the same objectives were pursued by means of direct national regulation.[114] Simultaneously, Member States may adopt marked based instruments in their national environmental policies due to Commission documents encouraging them to do so, or owing to publicity from case law concerning the environmental policies of other Member States which can encourage (or discourage) allow others to benchmark their instruments. Another reason for why market based instruments have been promoted by the Commission is that instruments such as taxes and trading schemes provide for a *continuous* incentive to reduce polluting and environmentally harmful products and practices. If environmental standards were promoted only through legislating emission limits, the incentivising effect would be lost as soon as the emission limit would be achieved.[115] In the absence of legislation on the EU level, the Commission has specifically suggested that Member States may adopt national environmental taxes in order to apply the PPP.[116] To summarise the principle objectives of environmental taxation, both national and EU –level objectives can be categorised in four points:

a) Internalising environmental externalities and implementing the PPP
b) Simplifying regulation to reduce administrative costs
c) Sustainable growth while maintaining competitiveness
d) Providing an incentive to continuous improvement of the environment.

[114] Kingston 2012, 95
[115] OECD 2007, 182
[116] Environmental Aid Guidelines, paras 8-10 and 21

4. Fiscal State Aid and the Cumulative Criteria

4.1. The Concept of Fiscal State Aid

The ECJ has consistently held that the notion of State aid is broader than that of a subsidy, and that the notion of an aid cannot be exhaustively defined by the Commission.[117] The notion is of a legal nature and should be defined by objective criteria.[118] Moreover, State aid is not limited to positive measures, but includes any measure whatsoever, which frees an undertaking from a burden it would otherwise have to bear. The ECJ has stated on countless occasions that the notion also encompasses tax measures, as it includes all measures which, '*in various forms, mitigate the charges which are normally included in the budget of an undertaking'*.[119]

The above interpretation has been referred to as the '*format neutrality*' of State aid.[120] The format neutral approach has become gradually more visible also in the practice of State aid control. The Commission has taken on a more active role in removing tax measures which are not compatible with the provisions on State aid since the late 1990's, when the Notice on State aid and direct taxation was published.[121] Since then, also indirect taxation has been specifically mentioned in the Commission's documents. For instance, in the 2004 implementation report the Commission state that the Notice on direct taxation provides for a basis of analysis also for indirect taxes as State aid.[122]

The format neutrality of state aid is closely connected to the *effect principle*, which is a critical element of notion of State aid.[123] The effect principle as established by the ECJ entails that the decisive element in determining whether a measure constitutes State aid is not the cause of the measure, but the effects thereof.[124] If aid can be granter in any form

[117] Raitio 2010, 593-594
[118] Case T-565/08 *Corsica Ferries* [2012], not yet reported, para. 88
[119] See for the quote and similar wordings *inter alia* case C-73/11 P *Frucona Košice a.s. v European Commission* [2013], not yet reported, para. 69; case C-81/10 P *France Télécom* [2011], not yet reported, para. 16; joined cases C‑78/08 to C‑80/08 *Paint Graphos* [2011], not yet reported, para. 45 and case C-487/06 P *British Aggregates* [2008] ECR I-10515, para 76
[120] Mamut 2010, para. 271
[121] Commission notice on the application of the State aid rules to measures relating to direct business taxation OJ C 384, 10.12.1998, pp. 3-9
[122] Report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation, C(2004) 434, 9 February 2004, para 71. See also Consultation document: State aid action plan - Less and better targeted state aid : a roadmap for state aid reform 2005-2009, SEC(2005) 795, COM/2005/0107 final, paras 18, 20, 21
[123] Aldestam 2005, 41
[124] Case 173/73 *Italy v Commission*, [1974] ECR 709, para. 13

what so ever, it is natural that it can only be identified through its effects. *Aldestam* has pointed out that Member States have become increasingly aware of the broadness of the scope of State aid control, which has prompted them to notifying tax measures to the Commission more frequently than before.[125] Yet, the increased activity still seems to focus on direct taxation, whereas indirect taxes have not been assessed as frequently in the Commission's and the ECJs practice, at least not when considering their importance in terms of tax revenues. Nevertheless, environmental taxes have already been subject to some proceedings, and more might be expected in the future, as the next State aid modernisation project is already up-and-running, including a future amendment of the Environmental Aid Guidelines.[126]

4.2. The Four Cumulative Criteria

In order for a state measure to be classified as prohibited state aid in accordance with Article 107 TFEU, the measure must fulfil four cumulative criteria expressed in the article.[127] If only one of the criteria is not met, then the measure in question cannot be classified as State aid. The same criteria naturally apply to taxation measures as well.[128] The interpretation of these criteria has mainly been established by the ECJ in its case law concerning state aid, but the implications of the case law have also been codified and clarified in a number of Commission guidelines, notices and communications.[129] Moreover, the Member States may have their own codifications concerning the practical implications or procedural questions related to applying Article 107 TFEU.[130]

The four cumulative criteria included in Article 107 TFEU are the following:

(1) There must an advantage conferred on an undertaking;[131]
(2) which is (i) granted by the State and (ii) through its resources;
(3) which favours certain undertakings or the production of certain goods, in other words, the aid must be selective;

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[125] Aldestam 2005, 52
[126] *See* Consultation paper on Environmental and Energy Aid Guidelines 2014-2020, European Commission, DG Competition, 11 March 2013
[127] Alkio 2010, 19–20
[128] See, *e.g.* Case C-53/00 *Ferring*, paras 14-16
[129] See, *e.g.* Environmental Aid Guidelines, OJ C 82, 01.04.2008, p. 1
[130] *E.g.* in Finland the guidelines on applying the rules on state aid have been codified in an Act '*Laki eräiden valtion tukea koskevien EU-säännösten soveltamisesta, 2001/300*'.
[131] According to *Aldestam* (2005, 65) it is questionable whether the criterion of the existence of an advantage actually follows from the wording of Article 107 TFEU, although it has been recognised by both the Commission and the ECJ.

(4) and the aid must be (i) liable to distort competition and (ii) affect interstate trade.[132]

Whenever all of the criteria above are fulfilled simultaneously, the measure in question constitutes State aid and must be notified to the Commission in compliance with the State aid procedure regulation.[133] However, the above criteria are not always presented in the same way.[134] Some criteria are considered to be interlinked in such a way that it is impossible to distinguish between them. Making rigid distinctions between different criteria may lead to difficulties in the assessment of a certain measure's compatibility with Article 107 TFEU.[135] Particularly conditions (1) and (3) often coincide and can be presented as one single condition,[136] whereas the fourth criterion can be divided in to two separate criteria; first, that of liability to distort competition and second, that of affecting interstate trade.[137] The ECJ therefore normally presents the criteria as:

(a) intervention by the State and through State resources
(b) liable to affect trade between Member States
(c) conferring a selective advantage on undertakings
(d) distorting or threatening to distort competition.[138]

In the interest of giving a balanced presentation I shall separate between conditions (1) *advantage conferred* and (3) *selectivity*. Since the criteria 4(i) *liable to distort competition* and 4(ii) *effect on interstate trade* are significantly interdependent and they have been given only limited attention in the case law of the ECJ, the two conditions shall be analysed together.[139]

4.3. Advantage Conferred on an Undertaking

In the case of taxation, it often follows from the nature of fiscal state aid, that the first criterion concerning *an advantage conferred on an undertaking* can often be presumed to be fulfilled. The concept of an undertaking may, however, at times require some

[132] Micheau 2012, 211; Bacon 2009, 24-25. See also opinion of AG Kokott, 4 September 2008, Case C-222/07 *UTECA*, [2009] ECR I-01407, 122
[133] Council Regulation (EC) No 659/1999
[134] Raitio 2008, 855
[135] Lang, Michael 2012, 411
[136] *See* case T-210/02 RENV *British Aggregates* [2012], not yet reported, para. 48; Case C-143/99 *Adria-Wien* [2001] ECR I-8365, para. 42
[137] See e.g. case C-206/06 *Essent Netwerk Noord,* [2008] ECR I-05497, para. 64,
[138] See *inter alia* Case C-451/03 *Servizi Ausiliari Dottori Commercialisti* [2006] ECR I-2941, para. 56, and Joined Cases *C*-341/06 P and C 342/06 P *Chronopost* [2008] ECR I-04777, para. 126.
[139] López 2010, 808. See *Nicolaides et.al.* 2005, 26 on the fact that a measure which has an effect on interstate trade is highly unlikely to not be liable to distort competition.

clarification.[140] The case law on the subject is vast, but in principle an undertaking is a private entity, not acting in the capacity of a public authority, who offers goods or services against remuneration on a market and who neither receives an unequal value for what it offers, nor has its transactions mandated by the state.[141] By contrast, non-profit-making organisations which are active in a purely social function are not regarded as undertakings.[142] Moreover, when it comes to indirect taxes, their purpose is to tax consumption, whereby consumers are often touched by tax measures. As consumers are not undertakings by definition, the concept of conferring an advantage becomes somewhat less obviously fulfilled where indirect tax measures are assessed.

Furthermore, the presumption of tax measures normally fulfilling the criterion of an advantage being conferred has been upheld by the ECJ.[143] In tax cases the criterion of selectivity and that of an advantage conferred are deeply intertwined, and must not necessarily be treated separately.[144] Nevertheless, in a recent Advocate General opinion, the two conditions of advantage conferred and selectivity have been kept apart as two separate conditions even if the case concerned a tax measure.[145] Apart from the question of determining whether the recipient of the advantage is an undertaking, I find that there are only very limited occasions when the two criteria should be separated in the context of fiscal aid.[146]

In general, the main reason to separate the two relates to the fact that some forms of aid should not be considered as advantages even if they are selective, since they have been conferred by State on equal terms as they would have been obtain from the market. A state can thus exercise economic activities in the role of a shareholder for instance, whereby its actions can be compared to the actions of private market actors.[147] In other than tax related cases, the criterion of an advantage being conferred is therefore usually verified by

[140] Nicolaides et.al. 2005, 14-15
[141] *ibid.*, 16
[142] See *inter alia* joined cases C-266/04 to C-270/04, C-276/04 and C-321/04 to C-325/04 *Organic* [2005] ECR I-09481, para. 54
[143] See *e.g.* Case C-124/10 P *Électricité de France (EDF).*[2012] not yet reported, para. 78; para. 16, Joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, paras 90-93; case C‑156/98 *Germany v Commission* [2000] ECR I‑6857, paras 25 to 28; and case C‑482/99 *Stardust Marine* [2002] ECR I‑4397, paras 68 to 70. See also Lang, Michael 2012, 417-418.
[144] Lang, Michael 2012, 419-420
[145] Opinion of AG Jääskinen, 8 July 2010, Joined cases C-78/08 to C-80/08 *Paint Graphos*, [2011], not yet reported, para. 68
[146] *Cf.* Aldestam 2005, 85-86
[147] Quigley 2009, 26

applying the Private Investor Principle (hereinafter 'PIP')[148] as introduced by the Commission.[149] The PIP essentially entails that a commercially justifiable financial measure which a private investor would adopt does not under normal conditions amount to State aid.[150] A private investor could not in reality adopt a tax measure, whereby taxes are public by nature. Therefore they are not comparable to a situation on the market that a private investor might face.[151] The GC has recently defended this view and stated that the conduct of the State should *never* be compared to that of a Private Investor when the State acts in its role of a public authority.[152] Even generally speaking, the application of the PIP on aid measures entails some rather debatable restrictions on Member State sovereignty, but these issues fall outside the scope of this dissertation.[153]

For purposes of clarity, however, it should be pointed out that there may be exceptional situations where fiscal measures can be subjected to the PIP-test and pass it, thereby not constituting State aid under Article 107(1) TFEU. First, the tax authorities of a state may become tax creditor in cases of bankruptcy. In such case, the tax authorities are imposed a double role as both a private creditors, striving for a result which is commercially satisfying, but also a public actor, whose interests include the survival of the company for reasons of employment and future tax revenues. Therefore, the State might be inclined to pardon, reduce or modify a tax debt of an undertaking in financial difficulties. In order to distinguish measures which confer an advantage on the recipient from those that are a part of normal creditor procedure, the PIP, or more precisely, the Private Creditor Principle, has been applied by the ECJ.[154] The same would naturally apply to a situation where the State would act as a creditor for environmental taxes.

Second, the PIP has been applied to a situation where a public company was granted a tax benefit. As the Member State was a shareholder of the company which benefitted from the tax advantage, the measure taken was considered to be comparable to a capital injection,

[148] Also called the *market economy investor principle* and the *market operator principle* or referred to as the *conduct of a prudent investor operating in a market economy*
[149] Raitio 2008, 860
[150] Kingston 2012, 380, Aldestam 2005, 41, Gavalda – Parleani 2010, para. 894, case C-457/00 *Belgium v Commission*, [2003] ECR I-06931, paras 47
[151] Graells 2012, 3; Raitio 2008, 860. See also D C (2003) 4637, Commission Decision 2005/145/EC of 16 December 2003 on the State aid granted by France to EDF and the electricity and gas industries, paras. 96-97.
[152] Case T-565/08 *Corsica Ferries* [2012], not yet reported, para. 79. See also case T-196/04 *Ryanair Ltd. v. Commission of the European Communities* [2008], ECR II-3643, para. 85
[153] See Parish 2003 for a comprehensive critique of the PIP.
[154] *See inter alia* case C-73/11 P *Frucona Košice a.s. v European Commission* [2013], not yet reported, para. 79; case C-256/97 *Déménagements-Manutention Transport SA (DMT)* [1999] ECR I-3913, para. 24-25

and was thus to be analysed under the PIP despite the advantage being granted in the form of tax relief.[155] As the distinction between the State as a public actor and a private actor continue to erode in many Member States, the relevance of the PIP may be increase in future tax related State aid cases.[156]

4.4. Granted by the State and through its Resources

4.4.1. Granted by the State

The second criterion is a can be divided in two parts, and has therefore been called the double control criterion.[157] First, the aid must be granted by the state, meaning either national or regional authorities, or public undertakings.[158] Second, the aid must be granted through state resources. Earlier on it was somewhat unclear how the wording of the article was to be interpreted, that is, whether both partial conditions were to be fulfilled at the same time or if it was sufficient that aid was either granted by the state *or* that it was granted through state resources.[159] The ECJ has since clarified that both partial conditions must be fulfilled in order to fulfil the criterion.[160]

As regards tax measures, this criterion can normally be presumed to be fulfilled as to both of the partial conditions due to the obvious connection between taxation measures and state resources. As expressed by Advocate General Kokott, *'a measure by which the public authorities grant to certain undertakings a tax exemption which, although not involving a transfer of State resources, places the persons to whom the tax exemption applies in a more favourable financial situation than other taxpayers, constitutes State aid within the meaning of Article [107(1) TFEU]'*.[161] In this regard, there should be no distinction made between taxation measures which grant an advantage by an exemption from a tax or by defining the scope of a tax so that it does not touch certain products or their producers.[162]

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[155] Case C-124/10 P *Électricité de France (EDF)*,[2012], not yet reported, paras 91-92 and 95, Case T-156/04 *Électricité de France* [2009] ECR II-04503, paras. 254-259
[156] Graells 2012, 5
[157] Jaeger 2012, 535
[158] Raitio 2010, 296
[159] The precise wording of Article 107(1) is: '*any aid granted by a Member State* or *through State resources*'.
[160] Case C-379/98 *PreussenElektra*, [2001] ECR I-02099, para. 58. See also Bacon 2009, 70-73, Kingston 2012, 385 and Jaeger 2012, 536-537 for discussion on this issue.
[161] Opinion of AG Kokott delivered on 2 July 2009 on case C-169/08 *Regione Sardegna*, [2009] ECR I-10821, para. 127, see also joined Cases C-106/09 P and C107/09 P *Gibraltar*, [2011], (not yet reported), para. 72; Cases C-78/08 to C-80/08 *Paint Graphos* [2011] (not yet reported), para. 46; and Case C-387/92 *Banco Exterior de España* [1994] ECR I-877, para. 14
[162] See Chapter 4.5.3 for an in-depth analysis of whether a tax measure must be a derogation from the normal taxation in order to constitute an aid.

However, the measure must also be imputable on the state, hence not a mere coincidence.[163] Due to the principle of legality of taxation, national tax measures are normally imputable on the State by law. The requirement of imputability is thus usually not contested in tax matters.[164]

Notwithstanding the above, it is worth bearing in mind that also provisions of EU law might require the adoption of tax measures. Implementing EU tax legislation may give rise to a certain product or industry being treated favourably. It is clear that measures necessitated by EU law cannot be imputed on a single Member State but rather the EU as a whole, whereby such measures do not constitute State aid.[165] The distinction between Union aid and State aid is therefore crucial to the application of Article 107(1) TFEU.[166] Distinguishing Union aid from State aid is particularly critical in issues of indirect taxation, and will therefore be more thoroughly discussed in Chapter 5.2.1 in connection with indirect environmental taxes.

4.4.2. Granted Through State Resources

The second part of the criterion concerning the aid being granted through state resources entails that State aid must include the use of State resources, whatever form it might take.[167] The criterion is such as to capture not only manifest and visible ways of transferring State resources to private undertakings, but also finely designed and discrete means of allocating resources.[168] Consequently, tax measures do not often escape the criterion. The Commission has established that granting a tax concession results in loss of revenues for the State, which should be interpreted as the State indirectly transferring resources to the recipient. [169] Other forms of aid do not necessarily involve any State

[163] Case C-482/99 *Stardust Marine* [2002] ECR I‑4397, paras 50-58
[164] See Englisch 2010, 263
[165] Kingston 2012, 391
[166] Englisch 2013, 14
[167] *See inter alia* Case C-278-280/92 *Spain v Commission* [1994] ECR I-4103, para. 22
[168] Gavalda – Parleani 2010, para. 889
[169] Commission notice on the application of the State aid rules to measures relating to direct business taxation OJ C 384, 10.12.1998, pp. 3-9, para. 10

funding, even when they confer advantages on undertakings. Such advantages cannot be regarded as State aid.[170]

However, it is worthwhile noting that the fact that losses incurred on the State are compensated by other incomes received by the State does not remove the element of aid being granted through State resources. Therefore, one cannot take into account the fact that a tax concession might be incentivising and lead to increased revenues for those subject to the tax, thereby giving rise to increased tax revenues for the State and offsetting the costs of the tax advantage granted in the first place. The positive overall effect that tax relief might have on public revenues does not change the fact that the aid is considered to have been granted through State resources.[171] Interestingly, however, it would seem from the wording used by the CG that the general rule of *State control* over the resources can be rebutted, if a measure to offset the deferment of tax revenues is directly imposed on the recipient. That can be done for instance by requiring that a deposit be paid to the State in compensation.[172]

Furthermore, the ECJ's interpretation of the condition of '*granted through state resources*' has been broad as measures which have neither been directly or indirectly funded by the State have been regarded as State aid. This has been the case where resources have been under the *control* of the State, whereby the aid has been considered to be granted through State resources even when it has not involved any State funds.[173] However, the broad interpretation does not extend to measures which are entirely privately funded, as was confirmed in the frequently cited case *PreussenElektra*. The case concerned an obligation imposed by the state to purchase electricity produced from renewable energy sources at a fixed minimum price, but included neither direct nor indirect transfer of State resources, and thus did not amount to aid.[174]

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[170] See, *inter alia*, case T-95/03 *Asociación de Empresarios de Estaciones de Servicio de la Comunidad Autónoma de Madrid and Federación Catalana de Estaciones de Servicio v Commission of the European Communities*, [2006] ECR II-04739, paras 87, 91, 104 ; joined cases C-52/97, C-53/97 and C-54/97 *Epifanio Viscido* [1998] ECR I-02629, para. 14 and joined cases C-72/91 and C-73/91 *Sloman Neptun* [1993] ECR I-00887, para. 21

[171] Report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation, C(2004) 434, 9 February 2004, paras 18-19; Lenaerts 2009, 296

[172] Case T-67/94 *Ladbroke Racing Ltd* [1998] ECR II-1, para. 20. The substantial parts of the judgment were upheld by the ECJ, see case C-83/98 P *Ladbroke Racing Ltd* [2000] ECR I-3271.

[173] *See* case C-345/02 *Pearle* [2004] ECR I-7139, para. 41; case C-482/99 *Stardust Marine* [2002] ECR I‑4397, paras 35-38; case T-67/94 *Ladbroke Racing* [1998] ECR II-1, paras 76-82,

[174] Case C-379/98 *PreussenElektra*, [2001] ECR I-02099, para. 59

4.5. Selectivity of the Measure

4.5.1. Selective and General Measures

The third criterion, selectivity, is quite often the most substantial one in the ECJ's test on prohibited state aid, and therefore deserves a detailed examination. The criterion is crucial not only in tax related cases,[175] but in most other State aid cases as well.[176] Selectivity indicates that the tax measure in question favours certain undertakings or the production of certain goods based on, *inter alia*, an exception from a tax provision of a legislative, regulatory or administrative nature or the practice of the tax authorities.[177] Despite different versions being presented by the Commission and the European Courts, the most cited definition of selectivity seems to be that of a selective tax measure being one that favours certain undertakings or the production of certain goods in comparison with others which are in a comparable legal and factual situation.[178] In more recent cases, the ECJ has added to the definition the notion of the undertakings treated differently having to be comparable in '*light of the objective pursued by the measure in question*'.[179]

Furthermore, a tax measure can be selective either to its *material* or *geographic* scope, which are addressed separately in the following chapters.[180] According to established case law of the ECJ, a measure is selective also if the authority issuing it has significant discretion over choosing the recipients, since a wide discretion makes it impossible to predict whether the measure will, in fact, end up favouring certain undertakings or certain goods.[181] Selectivity can also be described as a counterpart to the notion of discrimination, essential to Internal Market law, as selectivity implies positive treatment of an undertaking as opposed to discrimination which implies negative treatment.[182]

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[175] Nicolaides – Rusu 2012, 791
[176] Bartosch 2011, 178
[177] See Commission notice on the application of the State aid rules to measures relating to direct business taxation OJ C 384, 10.12.1998, pp. 3-9, para. 12; Nicolaides et.al. 2005, 24
[178] *See inter alia* joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], (not yet reported), para. 101; and joined cases C‑182/03 and C‑217/03 *Forum 187* [2006] ECR I‑5479, para. 119; case C-308/01 *GIL Insurance* [2004] ECR I-04777, para. 68; and case C-143/99 *Adria-Wien* [2001] ECR I-8365, para. 41
[179] *See inter alia* case T-308/00 *Salzgitter* [2013], not yet reported, para. 116; Case C‑279/08 P *Commission v the Netherlands* [2011], not yet reported, para. 52; but also *e.g.* case C-409/00 *Spain v Commission* [2003] ECR -01487, para. 47
[180] Report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation, C(2004) 434, 9 February 2004, p. 8-9
[181] *See inter alia* case C-256/97 *Déménagements-Manutention Transport SA (DMT)* [1999] ECR I-3913, 27
[182] De Cecco 2013, 97

Moreover, in relation to tax matters selectivity is often described by distinguishing selective measures from general tax measures, which are not prohibited under the rules concerning State aid.[183] According to the Commission, a general tax measure is one that is applicable to all operators on equal terms and where the tax authority has no discretion over granting the tax benefit.[184] Despite its common language connotations, it noteworthy that the term '*general measure*' is not related to the number of eligible undertakings nor the diversity and size of the sectors touched by the measure.[185] The Commission has clarified the notion of a general measure in its notice on business taxation in 1998. According to the Commission, technical measures as well as pursuing national policies by means of tax measures is in principle allowed as being general measures even if they might confer some advantages on certain sectors. Measures such as depreciations are therefore allowed,[186] as well as for instance reducing the tax burden of labour even though that indirectly favours labour intensive sectors.[187] Other technical tax measures include progressivity of a tax, which is normally considered to be a general measure.[188] In contrast, regressive taxation has been interpreted as an indication of selectivity.[189] In the case law of the ECJ, examples of general measures include measures an Italian tax measure promoting regularisation of firms in the black economy and a Dutch measure reducing the tax burden of the employer of employees in R&D –projects.[190]

Furthermore, the generality of a tax measure can be viewed as an element related to the how the national tax system is constructed. Hence, the ECJ has consistently held that a tax measure which can be justified by the general scheme of the taxation system in the Member State in question does not satisfy the condition of selectivity.[191] Adhering to the

[183] Alkio 2010, 69
[184] Commission notice on the application of the State aid rules to measures relating to direct business taxation OJ C 384, 10.12.1998, point 13
[185] Case C-143/99 *Adria-Wien*, [2001] ECR I-08365, paras. 48-49. *See also* Nicolaides – Rusu 2012, 798.
[186] Commission notice on the application of the State aid rules to measures relating to direct business taxation 98/C 348/03, para. 13
[187] Commission notice on the application of the State aid rules to measures relating to direct business taxation 98/C 348/03, para. 14. *Cf.* joined cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, where the ECJ held that the changed tax scheme where labour become more heavily taxed than before amounted to a selective measure since it conferred an advantage on offshore companies.
[188] Alkio 2010, 72
[189] Alkio 2010, 80
[190] Quigley 2009, 67-68
[191] Referred to already in joined cases C-72/91 and C-73/91 *Sloman Neptun* [1993] ECR I-00887, para. 21 and case C-200/97 *Ecotrade* [1998] ECR I-07907, para. 36, although in both cases the justification of a measure being inherent in the system was considered in connection with the criterion of aid being granted through State resources. See for a more recent reference, case T-210/02 RENV *British Aggregates* [2012], not yet reported, para. 48, where the system test is considered in connection with selectivity.

general scheme of the taxation system, or passing the '*system test*' as it is often referred to, means in essence that a tax measure is a direct result of the guiding principles of the national tax system.[192] Justifying a *prima facie* selective tax measure by the fact that it adheres to the general taxation system of the Member State is a test developed by the ECJ to assess selectivity in tax cases.

The notion of '*justifying*' the tax measure can be misleading as concept in this context, since as *Englisch* puts it quite convincingly, it is rather a question of ruling out the need for any justification under Article 107 TFEU.[193] If the tax measure is a consequence of the national tax system, the Article should not become applicable at all. This approach has in turn been criticised for going beyond the wording of the Treaty and for allowing Member States to circumvent the application of article 107(1) TFEU, whose wording includes no reference to the possibility of such justification.[194] However, excluding the possibility to refer to the national tax system as an indication of the generality of a tax measure would in my mind be rather restrictive on Member States' fiscal autonomy. Therefore, I agree with *Englisch* to the extent that the system test can be seen as a test for the generality of a tax measure, and not as a separate justification for a measure which is *prima facie* selective. In other words, a tax measure which pursues the general economic policy of a Member State by adhering to the guiding principles of that particular national tax system is a *general* tax measure by definition, and cannot be regarded as selective in the first place.[195]

4.5.2. Geographic Selectivity and Regional Autonomy

The notion of geographic selectivity entails that an otherwise general tax measure can become selective if it is applied to undertakings within a certain region.[196] However, selected regions within the EU have attained an autonomous position which is broad enough to create a politically and economically autonomous area, where taxation is the sole responsibility of the region. Where the regional authority is sufficiently autonomous, it is the regional area that constitutes the frame of reference in the selectivity test, as opposed to the benchmark being the entire Member State. This means that a reduced tax rate within

[192] Commission notice on the application of the State aid rules to measures relating to direct business taxation 98/C 384/0, para. 16. See also Englisch 2013, 11.
[193] Englisch 2013, 11
[194] Micheau 2011, 203
[195] Rossi-Maccanico 2009, 231
[196] Aldestam 2005, 76; López 2010, 810; de Cecco 2013, 120

a region could in principle be seen as non-selective, even if the rate would be lower in the rest of the country, if the rate is applied consistently and generally within the region.[197]

As to the assessment of geographic selectivity, the ECJ has established an interpretation concerning regional autonomy in the *Azores*-case. [198] Here, the ECJ held that in order for a tax measure to be considered State aid, the criteria of an advantage conferred must be assessed based on the normal level taxation in the relevant geographical area, which the Portuguese government argued to be *Azores* as a region.[199] In order to draw such a conclusion, however, the region in question must be sufficiently autonomous in relation to the central government, so as allow for the benchmark tax rate in the selectivity test to be limited regional geographical area and not the entire Member State.[200] Otherwise Member States could circumvent the selectivity test by decentralising certain limited taxation competences to regional authorities, while retaining the power to change, annul or adjust the regional tax rates.[201] In other words, there is a fine line between exercising regional fiscal autonomy and allocating State aid to a certain region.[202] Accordingly, the ECJ developed a test in order to distinguish between the two. The test adopted requires that the region in question meets the conditions of *institutional, procedural and economic autonomy*.[203]

Contrary to the more recent case of *Gibraltar*, the ECJ found that in the end, the *Azores* region was not sufficiently autonomous in *economic* terms. The conclusion was based on the fact that the Portuguese government could not prove that the loss of tax revenue due to the tax reduction in the *Azores* was not compensated by budgetary allocations of state funds.[204] In *Gibraltar*, however, the ECJ found that the preferential tax rate on offshore companies was not to be compared with the general tax rate in the UK, but instead it was to be compared with the tax burden of other companies in Gibraltar, since the region upholds a tax system of its own,[205] as the potential losses to be incurred by the tax

[197] Quigley 2009, 79; Alkio 2010, 79
[198] Case C-88/03 *Portugal v Commission*, [2006], ECR I-07115
[199] *ibid.*, paras 56-58 and operative part, see also joined cases C-428/06 to C-434/06 *UGT-Rioja* [2008] ECR I-06747, para. 51
[200] Quigley 2009, 80-81
[201] Alkio 2010, 81
[202] Quigley 2012, 113
[203] Case C-88/03 *Portugal v Commission*, [2006], ECR I-07115, para. 70, *see also* joined cases C-428/06 to C-434/06 *UGT-Rioja* [2008] ECR I-06747,75 and 87
[204] Case C-88/*03 Portugal v Commission*, [2006], ECR I-07115, para. 71-79
[205] Joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, para. 40

reductions were not to be offset by any subsidy from the UK.[206] The conclusion to be drawn from these cases is that economic autonomy can only exist if financial tax consequences are not offset by means of state funding, which has been allocated specifically in order to cover the tax consequences in question.[207]

4.5.3. The Derogation Approach and Critique Thereof

The definition of material selectivity is less coherent in the case law of the ECJ than that of geographic selectivity.[208] As regards tax measures, the assessment of material selectivity has been interpreted as being based on a so called '*derogation approach*'.[209] The derogation approach entails that a tax measure must constitute *a derogation* from the general tax scheme to satisfy the criterion of selectivity, meaning that the tax measure in question must depart from the normally applicable tax treatment.[210] The derogation approach can be seen as limiting the Commission's competence to review national tax measures, thus respecting the Member States' competence in tax issues.[211]

The approach has been criticised by various scholars, arguing that selectivity may be the result of both a reduced tax rate and the fact that some other sector is being taxed more heavily than other similar sectors.[212] According to this view, an aid can be selective even when it does not constitute a derogation, but simply because the scope of the tax measure is too narrowly defined in relation to its alleged and actual objectives.[213]

The derogation approach has, however, been applied in the case law of the Courts. The application of the approach on selectivity gives rise to a two-stage test.[214] The first stage of the test entails identifying the normal tax burden as a frame of reference, and only in the second stage can the potential derogation from it be detected. In the second stage the

[206] Lang, John Temple 2012, 806.
[207] Alkio 2010, 84-85
[208] Bartosch 2011, 178
[209] Aldestam (2005, 151) calls it the '*derogation method*' and Micheau (2011, 201) the '*derogation test*'.
[210] First introduced by AG Darmon in joined cases C-72/91 and C-73/91 *Sloman Neptun* [1993] ECR I-00887, para. 33.; Quigley 2009, 72-73. Here, Quigley refers to the ruling of the Court of First Instance (today the GC) in the *Gibraltar* –case (see full reference below) which has since been ruled upon by the ECJ.
[211] Quigley 2012, 112
[212] Aldestam 2005, 185
[213] Nicolaides – Rusu 2012, 791. See also Nicolaides 2001 for a criticism of the derogation approach.
[214] See also *Micheau* (2011, 203), who presents the system test, that is, the justification based on adherence to the general taxation scheme of the Member State as the *third* stage of the selectivity test.

measure can be assessed as to whether it amounts to selectively benefitting certain undertakings as opposed to other which are in a similar factual and legal situation.[215]

Yet for the purpose of Article 107 TFEU it seems unjustified that one would have to define which tax is the 'normal' tax and which one is the derogation. It can for instance be difficult to determine whether it is the lower tax rate which amounts to State aid when compared to the higher tax rate, or if it is the non-taxed products or industries which receive State aid when compared to those paying either the lower or the higher rate.[216] Moreover, defining a normal rate entails the issue of selecting a frame of reference – either wide or narrow. *Micheau* has illustrated the issue with the example of business taxation. In her example, a tax measure might seem selective in comparison to the general system of business taxation but in comparison with a narrower frame of reference, say the business taxation of SMEs, the measure could seem general.[217] Derogations from tax treatment, which already in itself is a derogation from a main rule complicate the process of determining the correct frame of reference and thereby the normal rate tax. This issue has been present in cases concerning the carry-forward of losses after changes of ownership.[218]

In addition, requiring a normal rate to be defined becomes problematic if the difference in taxation does not follow from the derogative nature of the tax measure, but the 'normal' application of the tax;[219] or where the tax is asymmetrically formulated in relation to the factual situation of the taxable persons.[220] One could say that this is the case when the State deliberately sets out to favour a group of undertakings by imposing a tax on one group, but leaving out the one that is favoured from the scope of the tax.[221] Therefore, an approach which does not necessitate the definition of the normal tax and the derogatory tax is more functional when assessing complex tax measures.

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[215] Lang, John Temple 2012, 805-806; Aldestam 2005, 180. See for the wording used by the ECJ, *inter alia* case C-88/03 *Portugal v Commission* [2006] ECR I-7115, paras 56-58.
[216] Bacon 2009, 66
[217] Micheau 2011, 204. *See also* Hancher et. al. 1999, 31-32.
[218] *See* C (2010) 970 final, State aid C7/2010 (ex NN5/2010) – Scheme on the fiscal carry-forward of losses, C (2010) 970 final, 24 February 2010, the appeal of which was rejected as inadmissible in case T-205/11 *Federal Republic of Germany v European Commission*, [2012], not yet reported. See also KHO 2011:118, which prompted a reference for a preliminary ruling, currently pending in the ECJ as case Case C-6/12: Reference for a preliminary ruling from the Korkein hallinto-oikeus (Finland) lodged on 3 January 2012 — P Oy, OJ C 58, 25.2.2012, p. 6–6.
[219] Joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, para. 93
[220] Opinion of AG Kokott delivered on 2 July 2009 on case C-169/08 *Regione Sardegna*, [2009] ECR I-10821, 128
[221] Bacon 2009, 69

On a few occasions, even the ECJ has departed from a strict derogation approach.[222] The ECJ took the view that that the derogation approach would lead to an interpretation where the selectivity-condition would require for a certain regulatory technique to be applied in order to qualify for state aid, which would be a rather formalistic view of fiscal selectivity. Such interpretation would have been and in contrast with the well-established effect principle.[223] As the ECJ has later again returned to an interpretation in line with its earlier derogation approach, the legal situation still awaits final confirmation.[224] Also, the practical problem of calculating of the *amount* of fiscal State aid without determining the normal level of taxation remains.[225]

4.6. Effect on Trade and Liability to Distort Competition

As mentioned before, the two conditions of liability to distort competition and the effects on trade between Member States are tightly intertwined as any measure which affects cross border trade will inevitably be at least liable to distort competition.[226] Therefore, if one of the two conditions is considered to be met, the same will normally apply to the other one. The application of these conditions to tax cases does not differ from that of other types of aid.[227] In general, the Commission has interpreted both conditions broadly.[228]

As to the effect on trade between Member States, the Commission is obliged to not only take into account the current intra-union trade of the product or service in question, but also any potential trade in the future.[229] Consequently, any measure that decreases the production costs of national products is liable to have an effect on trade between Member States, since producers of similar products from other Member States will consequently be less inclined to export their products to the country applying the production cost reducing measure.[230] The scale of the effect on trade is not relevant in the assessment, which has been made clear in case law where neither a) the market share of the undertakings receiving a tax advantage[231] nor b) the fact that the undertaking trades nearly exclusively

[222] *See* Case C-526/04 *Laboratoires Boiron* [2006] ECR I-7529, paras 33-39; joined Cases C-106/09 P and C107/09 P Gibraltar [2011], not yet reported, para. 90-92
[223] Joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, para. 90-92
[224] *See* joined cases C-78/08 to C-80/08 *Paint Graphos* [2011] not yet reported, para. 49
[225] Lang, john Temple, 811. See also the opinion of AG Jääskinen, 7.4.2011, Joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported.
[226] Nicolaides et.al. 2005, 26
[227] Di Bucci 2006, 84
[228] Parikka 2010, 4-5
[229] Joined cases T-447/93, T-448/93 and T-449/93 *AITEC* [1995] ECR II-01971, paras 139-140
[230] Case C-280/00 *Altmark* [2003] ECR I-07747, paras 77-79
[231] Case C-305/89 *Italian Republic v Commission* [1991] ECR I-1603, para. 26

with non EU states[232] have amounted to escaping the criterion, as long as the undertakings compete with other undertakings in the EU. In light of such a wide interpretation of '*effect on trade between Member States*' it is indeed difficult to imagine a situation where a tax related or other aid measure would not have an effect on interstate trade.[233]

Nevertheless, the ECJ's line of argumentation has demonstrated that it is the character of the market that ultimately determines whether a measure affects trade between Member States.[234] In fact, on a few occasions concerning local investment aids to SGEI services the Commission has concluded that trade is not affected.[235] By analogy, even a tax incentive, if applicable to a very specific or local market with little or no competition from other undertakings, could exceptionally escape the criterion.[236] The small scale of the sector being aided can also be relevant in the sense that tax reductions granted to small sectors amount to less aid in total than aid to large sectors, thus being more likely to fall under the threshold of the *de minimis*-regulation[237] whereby the aid would not be considered to affect interstate trade. [238] Moreover, aid which is in granted in compliance with the *de minimis*-regulation is not notifiable under Article 108(3) even when it meets all criteria under Article 107 TFEU.[239] In conclusion it seems that the Commission need little proof to be convinced that both conditions are fulfilled – namely that the amount of the aid exceeds the threshold of the *de minimis*-regulation.[240]

[232] Case C-142/87 *Kingdom of Belgium v Commission* [1999] ECR I-959
[233] Raitio 2008, 858
[234] See joined cases 62/87 and 72/87 *Exécutif régional wallon and SA Glaverbel v Commission of the European Communities* [1988] ECR 1573, paras 11-15, where the ECJ analyses the market situation of the recipient undertaking rather extensively
[235] Commission staff working document, COM(2007) 725 final, p. 12. See also C (2002) 2610 final, Commission decision in case NN 29/02 – Spain – Aid for the installation of service areas on Tenerife OJ C 110, 8 May 2003; Commission Decision in case N 543/2001 – Ireland – Capital allowances for hospitals OJ C 154, 28.6.2002 and Commission Decision in case N 258/2000 – Germany – Leisure Pool Dorsten, IP/001509 of 21/12/2000 OJ C 172, 16.6.2001
[236] See Parikka – Siikavirta 2010, 44 and Wouda Kuipers – Hernández Guerrero 2008, 37, who emphasize that such a scenario is possible only when related to fields with no competition or that concern a very restricted local interest.
[237] Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid, OJ 2006 L 379, p. 5-10, hereinafter the '*de minimis*-regulation'
[238] Recital 8 of the *de minimis*-regulation
[239] Article 2(1) of the *de minimis*-regulation
[240] Alkio 2010, 39

5. Environmental Taxes under 107 TFEU

5.1. The Dilemma of the Recipient of an Advantage

5.1.1. Empirical Indications of the Recipient of Indirect Fiscal Aid

As mentioned in Chapter 4.3 above, the first of the four cumulative criteria for State aid under Article 107(1) TFEU usually doesn't demand an extensive assessment by the Commission in order to be confirmed. However, environmental taxes are normally indirect taxes, which are by nature such as to allow the taxable undertakings to trickle down the tax burden to be borne by the final consumer.[241] It follows that there can be more than one beneficiary of indirect tax relief – first, the taxable person and second, the final consumer.[242] However, the wording in Article 107(1) TFEU clearly provides that state aid consist of an *advantage conferred on undertakings*. Let us call this the dilemma of defining the recipient. The first criterion of an advantage being conferred should therefore not be fulfilled, if no undertaking can be shown to be the recipient of the aid.

To fully appreciate the legal argumentation of actual beneficiary of indirect tax relief, it is worthwhile to take a brief look into how indirect taxes are transferred to consumer prices according to empirical data. On a general level, environmental taxes may be purposefully constructed so as to bring tax advantages as close to the consumer as possible: Such a design has the most notable effect on consumption. On the other hand, the design is less effective when it comes to affecting producer behaviour.[243] In Finland, empirical studies have shown that the degree to which indirect taxes are transferred to consumer prices varies significantly, and that as a starting point it can be assumed that about two thirds of the sum of an indirect tax is conveyed to the consumer prices.[244] As a result, only one third of the effects of the tax measure would benefit the taxable person.[245] By analogy, indirect tax relief would be less of an aid to undertakings than to consumers.

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[241] Especially as regards VAT, *fiscal neutrality*, implying *inter alia* that the burden of VAT can be passed on to the community in its entirety without burdening the taxable person, is considered inherent in the tax system itself as well as one of the fundamental principles that the VAT system is based on (see Rosas 2009, 277-278)

[242] Englisch 2013, 12

[243] Iire 2010, 272

[244] See Martikainen – Virén 2006, 7 concerning excise taxes and Virén 2005, 8 concerning VAT.

[245] It must be noted; however, that the results of the study on VAT referred to above was based on situations where the VAT rate had been *increased*, since that was the development of VAT rates at the time of conducting the research. The effect on prices might be more or less significant when it comes to a *reduced* VAT rate.

Moreover, reducing indirect taxes, for instance VAT, may have what could be called a '*signalling effect*'. This means that the publicity that a VAT reduction receives sends a positive signal to the consumers, who therefore change their consumption towards using the lower-rate product even where the price change in itself would not be significant enough to affect their behaviour.[246] It would be logical to assume that reducing the tax rate of environmentally friendly products has this effect on consumption – both the potential price reduction and the generally acceptable aim might encourage consumers to buy the product. Most tax reductions are, however, directed at products not for their environmental purposes but to relieve them from the additional burden caused by environmental taxes. Such measures would not benefit from the goodwill effect of environmental aims, although the price effect would naturally remain.

To sum up, the taxable undertaking can benefit from a tax reduction in two ways. First it can keep part of the tax reduction to itself. Second, it can benefit from consumers buying its products due to the free publicity received from the VAT reduction and the environmental objectives behind it. In addition, the effects that indirect taxes have on prices are also typically such that they increase over time. The immediate effects can be rather negligible, while on a long term prices might reflect the change in indirect tax more accurately.[247] It therefore seems indisputable that undertakings receive at least some benefits from indirect tax reductions.

5.1.2. Legal Interpretation of the Recipient of Aid

The Commission has interpreted the dilemma of the recipient so that when an undertaking is required by law to transfer a tax benefit to its clients, that undertaking does not receive an advantage itself. Such measures will consequently escape being defined as State aid under Article 107(1) TFEU.[248] However, an analogical interpretation of the recent GC case of *Corsica Ferries* would imply that even if the direct benefit of a tax measure is directed at employees (of a specific company), the measure does not necessarily escape the Article 107(1) TFEU definition of State aid. Instead, the tax benefit can be considered as an

[246] See Määttä 2006, 60, who calls it the '*conscience effect*'.
[247] Martikainen – Virén 2006, 5. See, however, *Honkatukia et. al.* 2011, 10-11, indicating that in some studies a reduced VAT has actually had its most significant effect on prices immediately after its introduction.
[248] C (2007) 4297 final, in State aid N715/06, Finland: Tax Exemption to Finnvera Oyj, paras 14-18

advantage conferred on the undertaking employing the recipients of aid.[249] Indirect ways of transferring advantages to private persons instead of undertakings are thus sometimes caught by the notion of State aid, and at other times not.

Owing to the aforementioned ambiguity in case law, I shall in the following examine whether the benefits of a preferential indirect tax scheme (concerning an environmental tax) can be argued to be conferred on consumers. Were that the case, indirect tax measures would fall entirely outside the scope of Article 107 TFEU. Such a conclusion could encourage Member States to adopt tax relief measures from indirect taxes in order to attract undertakings from other Member States. This, in turn, would be contrary to the objective of combatting harmful tax competition with State aid control.

Firstly, the Environmental Aid Guidelines bring forward the possibility to pass on costs to consumers as an element which must be considered when assessing the compatibility exemptions and reductions from environmental taxes under Article 108(3)(c) TFEU. According to the guidelines said type of fiscal aid can be considered necessary only if it can be shown that environmental tax without reduction would lead to a substantial increase in production costs for the undertakings concerned, where those costs cannot be passed on to the consumer.[250] Moreover, in the Consultation Paper regarding the modernisation of State aid the Commission has also recognised the difficulty of proving that tax relief has not been passed on as required by the Environmental Aid Guidelines.[251]

Second, the above reasoning regarding the allocation of the advantage between the taxable person and the final consumer has been addressed indirectly by the ECJ. The cases concerned Member States' duty to reimburse taxes that have been collected on false grounds or in excess.[252] In its assessment, the ECJ has taken the view that first, not all taxes levied on a taxable person are necessarily transferred into the prices. Price elasticity and product substitutability are key factors in defining how much of a levy can actually be passed on. Furthermore, taking its evaluation to an even more realistic or economic level, the ECJ has also held that a tax measure may have an *indirect effect* on the taxable person,

[249] Case T-565/08 *Corsica Ferries* [2012], not yet reported, para. 137. One imaginable situation where this could become applicable in the context of environmental taxes, could be a situation where the excise on petrol was exempted for certain groups of employees as an incentive for them to stay in a region where commuting to work gives rise to exceptionally high petrol costs.
[250] Environmental Aid Guidelines, points 158(c) and 159(a).
[251] Consultation paper on Environmental and Energy Aid Guidelines 2014-2020, 16
[252] *See inter alia* Case C-398/09 *Lady & Kid* [2011], not yet reported

regardless of the immediate tax burden being passed on to the consumer. For instance in *Lady & Kid*, the ECJ pointed out that even when fully encompassed in the consumer price, the taxable person may still suffer from an unjustly increased tax rate.[253] In other words, even when passing on the entire immediate costs of a tax increase to consumers, the negative effects of having to increase prices might not be compensated by the increased revenues attained from higher prices.[254] The costs of the higher tax rate therefore partly burdens the taxable person. By analogy, despite prices having been reduced in proportion with the tax relief, a preferential rate or an exemption from an indirect tax could imply an advantage for the taxed undertaking itself and instead of the final consumer. This in turn could be seen as a balancing out of advantages gained and advantages passed on.

Taking all of the above elements into account when analysing the recipient of indirect tax relief renders the assessment State aid rather complicated. The ECJ has indicated that a more detailed assessment of the "passing on" of indirect taxes should be applied, however not in context of State aid.[255] Such a detailed assessment would include an evaluation of (a) how much of the indirect tax relief has remained with the taxable person, and how much has been passed on to the final consumer, and (b) whether the taxable person has obtained indirect advantages in terms of *e.g.* goodwill or market share through the tax measure. Those indirect advantages may in turn have been accrued by virtue of the reduction consumer prices or the '*signalling effect'* that tax reductions may have through publicity. Evidently, the same signalling effect can apply the other way around, so that an increased indirect tax or levy, especially in connection with outspoken environmental aims, may influence consumer behaviour significantly. The Irish levy on Plastic Bags provides for the textbook example of such an effect, as a 15 cent levy on plastic bags introduced in 2002 led to a 90 % reduction in the use of plastic bags. [256] Whenever (a) and (b) amount in total to no aid remaining with the taxable person, no State aid in the meaning of Article 107(1) TFEU would be granted.

Drawing on the above interpretation, the assessment of possible costs having been passed on to consumers should be an economically oriented one. Surely, as the empirical studies referred to above have shown, it is true that changes in indirect tax rates affect both consumer prices and the revenue of undertakings. This would also be in line with the

[253] Case C-398/09 *Lady & Kid* [2011], not yet reported, para. 21
[254] See Case C-147/01 *Weber's Wine World* [2003] ECR I-11365, para. 99
[255] *Ibid.*, para. 100
[256] Convery et.al. 2007, 8

objectives on environmental taxes, namely internalising environmental externalities in order to improve the environment. As passing on tax relief would exclude the definition of the measure as State aid, undertakings could be encouraged to pass on tax relief to full extent. However, a more negative consequence of introducing an economically oriented assessment of the recipient of indirect tax aid would be that it would add to the workload of the Commission.

Undeniably, it does not seem reasonable from the point of view of the undertakings receiving an indirect fiscal benefit that fiscal aid would be determined at its nominal value, without due concern of a part of the advantages received having been passed on to the consumers.[257] Such an approach may further discourage undertakings from taking indirect tax benefits into account in the prices of products in general. This in turn undermines the effect of indirect tax relief intended at reducing pollution, since the price would no longer reflect the indirect tax relief. Consequently such tax measures would no longer be capable of steering consumption towards products that are environmentally friendlier. The objective of incorporating environmental externalities would not be complete. Since it would in any case be difficult to prove that all of the indirect tax relief from the environmental aid has been passed on to consumers and that the overall incomes have not increased as a result, the condition of an advantage conferred to an undertaking would only rarely be escaped.

5.2. Environmental Aid Granted by the State and Through its Resources

5.2.1. Distinguishing between State aid and Union aid

Since tax measures usually imply a form of tax expenditure from the state, also an environmental tax is presumed by definition to have been granted by the state.[258] This presumption might however be rebutted if the aid is a direct consequence of EU policy. As such, this defence entails that where the aid derives from EU legislation, it is not per definition granted by the State, but rather by the EU. Concerning indirect environmental taxes, the influence of EU legislation is significant, since indirect taxes have been harmonised extensively in the EU. Following *Englisch*' line of argumentation, the main

[257] Such an approach has been adopted by the GC albeit in the context of direct taxation. See case T-445/05 *Associazione italiana del risparmio gestito and Fineco Asset Management SpA v Commission of the European Communities*, [2009], ECR II-00289, para. 201 where the entire fiscal aid was to be recovered from the taxable person.
[258] See Chapter 3.1.2

question to be asked is whether the tax measure in question can truly be imputable on the Member State, or if it directly from provisions of EU law.[259]

In assessing the difference between State aid and Union aid, the Commission has applied a strict interpretation, according to which only aid which is specifically required by EU law can escape the scope of application of Article 107(1) TFEU. This approach was adopted in a case concerning Slovak tax advantages applied on electricity, coal and natural gas. The Commission pointed out that although the advantages in question were *permissible* under the harmonised EU provisions, they were not *required* by Union law. Therefore, the advantage was imputable on the Slovak state, fulfilling the second State aid criterion.[260] In *Puffer* the ECJ confirmed that consequences of tax measures which are required by EU law do not amount to State intervention, and thus are not State aid.[261] Moreover, in *Mineral Oils* the tax exemption from excise duty on mineral oils for alumina production was based on Council decisions, and could therefore not be interpreted as tax measures which were imputable on the individual Member State. [262]

Therefore, if the granting of a selective tax advantage is mandatory or expressly allowed under harmonised EU tax law, the effects cannot be attributed on the Member State.[263] When it comes to optional tax relief as provided by inter alia the VAT system, the Member States have to make an independent decision as to whether or not to adopt a certain measure. Such changes are often easily detectible in VAT-rate tables.[264] Where an option to reduce a VAT rate is used, the GC has held that the measure can constitute state aid.[265]

This conclusion is also supported by Directive 2003/96/EC, which specifically states that *'optional measures authorized by this Directive may still constitute State aid'*.[266] Consequently, the possibilities of escaping State aid control by arguing that the aid is not imputable on the Member State but on the EU are limited. In a way this is regrettable since it might lead to Member States being less inclined to use options in the Directives in order

[259] Englisch 2013, 11
[260] C (2009) 10745, SA.25172, Slovak Republic: Tax advantage applied on electricity, coal and natural gas, (NN 63/2009 ex. N 83/2008), 23 December 2009, para. 32
[261] Case C-460/07 *Puffer* [2009] I-03251, 70-71
[262] Joined cases T-50/06 RENV, T-56/06 RENV, T-60/06 RENV, T-62/06 RENV and T-69/06 RENV *Mineral Oils*, [2012], not yet reported, para. 94
[263] Englisch 2013, 15. See also Kingston 2012, 391
[264] Siikavirta 2007, 106
[265] Case T-351/02 *Deutsche Bahn* [2006] ECR II-1047, para. 100 and joined cases T-50/06 RENV *Mineral Oils* [2012] (not yet reported), para. 73.
[266] Council Directive 2003/96/EC, Article 26(2)

to go further in their environmental taxation than what has been achieved on an EU level. In addition, the options may provide for a possibility to fulfil one of the objectives of environmental taxes that is incentivising continuous improvement of the environment. Having achieved the level set in the Directive, Member States could move to more stringent environmental tax provisions allowed for in the optional provisions of the Directive. The strict interpretation of the distinction between State aid and Union aid requires that any such tightening of environmental taxes must be notified to the Commission.

5.2.2. Privately Funded Aid and Concealed State Aid

As discussed earlier in this dissertation, the second criterion of Article 107 TFEU requires that aid be financed either by the State, or by funds which are controlled by the State. This means that measures which channel support through private funding may in principle escape the scope of Article 107(1) TFEU.[267] Therefore, a national provision according to which private undertakings must use environmentally friendly products and finance their production by paying more than the market price for them, is not necessarily in breach of Article 107 TFEU, even if it leads to a certain environmentally friendly product or industry being favoured.

In order to avoid being defined as State aid, tax measures have often been separated from aid measure so as to exclude the criterion of "*granted through state resources*". This is typical for energy tariff systems, which often include a tax or a levy intended to finance the tariff. What seems like a privately funded measure for the environment – paying a higher tariff for environmentally friendly energy – might be compensated by State resources in one way or another. Therefore, the distinction between privately financed environmental aid and publicly financed aid has been carefully scrutinised precisely in cases concerning energy tariffs.[268]

Detecting aforementioned concealed State aids means applying the effects principle and not being bound to the form of the measure. Moreover, the measures must be considered in context and as a whole, since the aid itself is separated from its financing. In order to prevent circumvention of State aid control, the ECJ has adopted the following interpretation. If an aid measure which is allocated by private entities is compensated by

[267] See for criticism of the second part of the double control-criterion, Jaeger 2012, 535-538
[268] See *inter alia* C-206/06 *Essent*, [2008] ECR I-05497; Case T-25/07 *Iride SpA* [2009], ECR II-00245

tax measures which are hypothecated to the aid – there is State aid. The aid measure becomes an integral part of the aid measure and should therefore itself be regarded as contrary to Article 107(1) TFEU.[269] However, the State need not necessarily participate in the funding of an aid through typically stately interventions, such as compensatory tax measures, in order for an aid to be considered as State aid under Article 107 TFEU. Indirect forms of support to environmental tariff systems, for instance parafiscal charges levied on consumers, can lead to the measure in its entirety to be classified as State aid. This is demonstrated by the following cases.

The frequently cited case *PreussenElektra* was a positive decision for those Member States wishing to pursue environmental policies by fiscal means without having to confront State aid control. In said case the ECJ made a distinction between what could be considered an indirect transfer of State resources and what could not. According to the judgment an indirect transfer of State resources does not encompass situations, where the state imposes an obligation on undertakings to purchase electricity produced from renewable energy sources at a fixed minimum price, since it includes no transfer of State resources. Instead, the aid originates from private resources, and should not be considered as State aid. [270]

The subsequent rulings introduced a more stringent interpretation of the difference between privately funded aid and notifiable State aid. The refined approach taken by the ECJ is understandable as a wide interpretation would allow for States to disguise aid measures as privately funded aid and consequently escape State aid control. In *GEMO*, the ECJ had already clarified that the subject of the tax measure and the aid measure does not have to be the same taxable person.[271] In order for the condition of '*state resources*' to be fulfilled in such a case, the tax measure must be *hypothecated* to the aid measure, so that it forms an integral part of the aid granted.[272] Where taxation forms an integral part of a prohibited aid granted to an undertaking, also the tax measure itself should be considered illegitimate.[273] Hypothecation means first, that the tax revenues necessarily be used for the financing of the aid in question. In other words, the tax measure, levy or parafiscal charge

[269] This principle was applied already in Case C-174/02 *Streekgewest* [2005] ECR I-85, para. 26. *See also* Case C-175/02 *Pape* [2005] ECR I-127; Joined cases C-393/04 and C-41/05 *Air Liquide* (C-41/05) [2006] ECR I-5293, para 46
[270] Case C-379/98 *PreussenElektra*, [2001] ECR I-02099, para. 59
[271] Case C-126/01 *GEMO* [2003] ECR I-13769. The case concernes an obligation to collect animal carcasses for free from farmers and slaughterhouses, which was imposed on private undertakings, but where that obligation was financed by a levy on meat products, which was paid by the relaters of meat products.
[272] See case C-174/02 *Streekgewest* [2005] ECR I-85, para. 26, concerning a Dutch waste levy.
[273] Gavalda – Parleani 2010, paras 888 and 891

must have been adopted for the financing of an aid measure.[274] Second, it means that the revenue of the tax must have a direct impact on the amount of the aid.[275]

Furthermore, in *Essent*, the ECJ narrowed the scope of application of its interpretation in *PreussenElektra* by concluding that even where the proceeds of a levy are entirely the possession of private entities, but where excess amount must be paid to the minister and were the proceeds are not to be used to other purposes than those provided for by law, the element of State aid control is sufficient to meet the criterion of state resources.[276] A similar interpretation as that applied in *Essent* has since been adopted by the GC in another energy charge related case, *Iride*.[277] In *Iride*, the element of State control was perhaps more evident, since the revenues of the contested electricity tariff were managed by a public fund.[278] Hence, what seems like privately funded aid can in fact be identified as concealed State aid when connected to either compensatory tax measures for the taxable person or tariffs levied on the final consumer for the benefit of the taxable person.[279]

In subsequent Commission decisions concerning tariff systems, the approach has been similar as in *Essent* and *Iride*, further narrowing down the scope of application of the interpretation in *PreussenElektra*. Almost any connection to public power seems to be interpreted as State control over the revenues. In a case concerning the Austrian feed-in tariff, the approach appeared particularly strict. The difference of the market price and fixed minimum price of renewable electricity was financed by a levy imposed on final consumers, which was collected and redistributed by a *prima facie* private "Eco-balance group".[280] The Commission assessed the criterion of State resources separately for the set minimum tariffs and the levy raised to compensate the difference between prices and tariffs. As to the levy imposed on consumers, it relied on the early case of *Steinike & Weinlig*.[281] According to said case law the levy (i) must be imposed by the State; (ii) its

[274] Coutrelis et al. 2012, 541
[275] Case C-206/06 *Essent* [2008] ECR I-05497, para. 90. See also C 325/04 *Organic* [2005] ECR I-9481, para. 40 and Case C-174/02 *Streekgewest* [2005] ECR I-85, para. 26.
[276] Case C-206/06 *Essent*, [2008] ECR I-05497, paras 66-75
[277] Case T-25/07 *Iride* [2009], ECR II-00245, the substantive part was upheld by the ECJ in Case C-150/09 P *Iride* [2010] ECR I-5, operative part
[278] Case T-25/07 *Iride* [2009], ECR II-00245, para. 27
[279] See also Reference for a preliminary ruling from the Conseil d'État (France) case C-262/12 *Association Vent De Colère! Fédération nationale*, OJ C 243, 11.8.2012, p. 8 relating to the case before the French Conseil d'État: CE, décision n:o 237466 du 21 mai 2003.
[280] C(2006) 2955 State aid NN 162/A/2003 and State aid N 317/A/2006 – Austria: Support of electricity production from renewable sources under the Austrian Green Electricity Act (feed-in tariffs), 04.07.2006, OJ 2006 C 221/8, 2*ff*
[281] *ibid.*

proceed must be poured into a body designated by the State (this body does not have to be State owned, not do the proceeds have to become the property of the State); (iii) the proceeds must be used to give an advantage to certain undertaking for it to constitute State resources.[282] Moreover, the Commission regarded also the price-setting mechanism to constitute State aid. This conclusion was based on the fact that the representatives of the Eco-balance group were chosen from three high voltage grid operators, which were partly State owned. This, in the Commission's assessment sufficed to fulfil the condition of State *control* as referred to above in Chapter 4.4.2.[283]

However, as the ECJ has stated, even where an advantage is conferred through a public undertaking, it should not be taken for granted that the State has been the one making the decision.[284] Therefore, I find the reasoning of the Commission somewhat insufficient in the case of the Austrian feed-in tariff system. At least a more thorough analysis of how the State controlled the resources through the representatives in the Eco-balance group could have enlightened the interpretation. It remains to be seen how different national adaptations of environmental tariff systems will be assessed by the ECJ in the future.

Recently a number of Member States have in fact adopted feed-in tariff regimes for renewables which have been notified and approved following the Environmental Aid Guidelines. Those regimes have not been connected to tax measures, but to direct subsidies covering the difference between market prices and the set minimum tariffs.[285] Pursuing environmental policy by tariff regimes seems to quite challenging unless submitting the measure to the Commission's approval before implementing it. Because of this, it is tempting to draw the conclusion that imposing minimum tariffs combined with parafiscal levies on consumers instead of straight out tax measures is not a very elegant solution for pursuing environmental policy, at least not if one's intention is to avoid State aid control.

The *PreussenElektra*-case has only a very limited effect as excluding the notification requirement under Article 108(3) TFEU regarding tariff regimes. Implementing a system similar the one in *PreussenElektra*, could in my view escape notification duty only if no

[282] Case 78/76 *Steinike & Weinlig* [1977] ECR 595
[283] *See inter alia* Case C-482/99 *Stardust Marine* [2002] ECR I-04397, paras 35-38
[284] Case C-482/99 *Stardust Marine* [2002] ECR I‑4397, para. 52; case C-345/02 *Pearle* [2004] ECR I-7139; paras 35-36
[285] *See inter alia* C (2010)2445 State aid N 94/2010 – United Kingdom: Feed in Tariffs to support the generation of renewable electricity from low carbon sources, 14.04.2010; C (2011) 1750 State aid SA. 31107 2011/N – Finland: Operating aid for energy production from wind power and biogas, 15.03.2011

levy is imposed on consumers neither by the State nor electricity buyers if they are State owned. Clearly, the consumers will in any case end up financing the tariffs at least to some degree, but to avoid being construed as granted through State resources, transferring the costs into prices should be left to the private undertakings. In light of the objective of simplifying regulations to reduce administrative costs, leaving the price issues to be dealt with by the private sector entirely without introducing complicated systems of transferring costs to consumers by State means could be a recommendable solution. That is, if the Member State prefers financing the tariffs by levies and parafiscal charges instead of direct public funding in the first place.

5.2.3. The French Model – Financing Aid Measures with Taxes and Levies

Several of the French environmental aids seem to be constructed in a similar way with the measures discussed above. Such taxes are constructed so that the allocation of aid and the tax measure are two separate measures connected to each other by different mechanisms. These types of measures have been referred to as '*closed systems*' of environmental tax aid, and their effectiveness has been considered to be better than that of other fiscal aids for the environment.[286] Therefore an examination of the acceptability of the French model is worth examining.

A successful example of a 'closed system' which was considered not to constitute fiscal state aid is that of case *Doux Élevage*. The case concerned a levy, which is collected from turkey farmers and producers and redistributed to finance the mutual costs by an inter-trade group consisting of trade organisations in the agricultural industry, without interference of state revenues.[287] However, the levy which had been agreed upon within the inter-trade group was extended to apply by law to all traders within the industry and not only those who were parties to the inter-trade group contract. The ECJ concluded that despite the legal obligation to finance the services provided by the inter-trade group, the state budget was not involved and the aid therefore remained private to its nature. Article 107(1) TFEU was therefore not applicable on the arrangement.[288]

Not all similar models of closed systems of environmental fiscal aid have, however, passed the test of "granted through State resources". Before 2001, the French system for aiding

[286] Iire 2010, 273
[287] Case C‑677/11 *Doux Élevage* [2013], not yet reported, paras 43-45. *See also* case C-345/02 *Pearle* [2004] ECR I-7139.
[288] Case C‑677/11 *Doux Élevage* [2013], not yet reported, paras 43-45 and operative part

farmers and slaughterhouses dispose of animal carcasses (which are classified as hazardous waste) was constructed so that retailers were obliged by law to pay a certain levy on meat products, while the revenues of that tax were allocated to private carcass disposal services via a fund. Animal carcasses exceeding a certain weight as well as all carcasses from slaughterhouses were to be disposed of by means of the service pursuant to the legislation. The service was free of charge, which already implies that the PPP and the objective of internalising environmental costs are not adhered to. The system suffered a major setback when the ECJ concluded in its decision in 2003 that the tax amounted to State aid to farmers and slaughterhouses under Article 107(1) TFEU.[289] The ruling built on the fact that although it was the retailers who paid the tax and the slaughterhouses that benefitted from the animal waste service, the aid was granted through the State since the animal waste services were financed by a fund to which the retailers taxes on meat products were allocated. Moreover, the animal waste service providers through had concluded contracts with the departmental prefects.[290]

Pursuant to the decision, the legislation was changed in order to comply with EU law, and was followed by several national administrative procedures where retailers were reimbursed the unlawfully levied taxes.[291] The system has since been reconstructed so as to exclude any intervention of state resources in order to comply with the logic of the case *PreussenElektra* and subsequent case law. The current tax on meat products is thus not directed at a specific fund but is now allocated to the general State budget, whereby the hypothecation and connection with the aid has been discontinued. The criticism that certain scholars have pointed at in relation to the *PreussenElektra* –case implies that said case encourages Member States to adopt measures with similar effects as aid schemes, but by excluding state resources so as to circumvent the application of Article 107(1) TFEU. The fact that the French legislator amended the meat taxation scheme in the aforementioned way is, in my opinion, an example that backs up such criticism.[292]

In light of more recent case law, namely the aforementioned case *Essent*, the non-application of Article 107(1) TFEU on the current French tax on meat products can, in my

[289] Case C-126/01 *GEMO* [2003] ECR I-13769, para. 44
[290] *ibid.*, paras 24-27
[291] Ayache – Ghaddab 2012, 103. See for case law, *inter alia*, Cour administrative d'appel ('CAA') Nantes, 26 juillet, 2012. N° 12NT01317 et 12NT01316 and Conseil d'État ('CE'), 22 octobre 2012, N° 348856 Toupargel.
[292] See for the criticism of the imputability condition Jaeger 2012, 537

opinion, be questioned. In *Essent* the measure was considered as imputable on the State precisely because a levy was charged from the consumer – much like how an indirect tax would be applied. Therefore, it would seem as a formalistic approach instead of one which focuses on the effects of a measure, if the tax on meat products could no longer be considered as State aid, only because they pass through the general budget and not a specific fund.

The *Essent* case prompted the French Conseil d'État to question two decisions concerning the French tariff system for wind power. The case *Vent de Colère* is currently suspended in the Conseil d'État, as it has referred a preliminary question on the subject of State aid to the ECJ.[293] The case concerns the obligation on private electricity providers (ÉDF included) to purchase all electricity produced by renewable sources at a higher than market price, set by a Decree of the Ministry of Economy and Energy. The costs incurred by that obligation are compensated by a public fund, which collects its resources from a tax imposed on electricity producers, providers and distributors.[294] In 2003, the Conseil d'État had already once approved of the measure and opined in line with *PreussenElektra* that since the measure was not financed by the State. However, by 2008 the Decrees had been amended so that the surcharge of the obligation to buy all renewable energy at a fixed price was no longer financed by a specific fund, but by a specific levy on the final consumers of electricity. The structure of the measure is thus nearly identical with that of *Essent*, only the objective is different, as in *Vent de Colère* the system specifically justified by environmental objectives. Following the above reasoning as well as the recent opinion of AG Jääskinen, I find that the most likely scenario is that the ECJ will deem the wind power tariff regime to fulfil the criterion of aid being granted through state resources.[295]

Finally, the issue of distinguishing privately funded aid from State aid was recently addressed in the Court of administrative appeals of Lyon concerning a case on an environmental aid to sustainable fishery, where the aid measure was once again financed through a separate levy.[296] However, the levy is not, according to the Court of administrative appeals of Lyon, hypothecated to the aid measure, but paid to the general

[293] Case C-262/12: Reference for a preliminary ruling from the Conseil d'État (France) lodged on 29 May 2012 — *Association Vent De Colère! Fédération nationale*, OJ C 243, 11.08.2012 p. 8 – 8 (case pending)
[294] Coutrelis et.al. 2012, 540
[295] Opinion of Advocate General Jääskinen 11 July 2013 in case C-262/12 *Vent De Colère* [2013], not yet reported, para. 57
[296] CAA Lyon, 6 novembre 2012, N° 12LY00561 et 12LY006354, para. 1

budget, and therefore not State aid.[297] Moreover, the Commission had not raised objections against the measure in its decision in 2008.[298]

All of the aforementioned issues are built on systems where the person under the environmental obligation is not the taxable person. The scheme is a typically French way of constructing fiscal environmental incentives. The French Government has also brought this up in their answer to the Commission's public consultation on the Environmental Aid Guidelines.[299] In its answer the French Government emphasised the benefits of closed systems of taxing and then aiding a certain sector with the proceeds of the tax. The reimbursement in the form of an aid would not be redistributed in proportion to environmental harm or pollution. Instead the distribution could be based on the objective of competitiveness, for instance. The French Government argued that in such a way, the incentivising effect as well as the signalling effect of an environmental tax are maintained while the tax itself remains '*environmental*' to its nature and does not include exemptions amounting to harmful subsidies.[300]

I find the arguments of the French Government are rather convincing, as they coincide what has been suggested as effective ways of adopting environmental taxes. Where the proceeds of a tax are directed at a specific environmental activity, the financing measure becomes transparent in the sense that both the public and the polluters are aware of how the proceeds of the tax are used. In the eyes of tax payers and consumers, such taxes can seem more legitimate.[301] Moreover, such a system may help maintain competitiveness of the sector being taxed, one of objectives of environmental taxes. On the other hand, the mere imposition of an incentivising tax without directing the proceeds to be used for any particular purpose does perhaps fall more in the logic of the PPP and the objective of internalising environmental costs into prices. By this I mean that if a tax is levied on an environmentally harmful product, the use of such product should be reduced as a consequence of the higher price. Consequently, the need for funding in order to combat the environmental problems related to the product would be reduced as well.[302] Therefore,

[297] CAA Lyon, 6 novembre 2012, N° 12LY00561 et 12LY006354, paras 5-6
[298] C (2008) 5607 final, Aide d'Etat n ° NN 9/2008 – France: Plan de sauvetage et de restructuration, 8 Octobre 2008, para. 81
[299] Réponse des autorités françaises au document de consultation sur les aides d'État à la protection de l'environnement 2012, 23-24
[300] *ibid.*, 23-24
[301] Määttä 2006, 74
[302] *Cf.* Määttä 2006, 76

there would be no interest in directing the decreasing tax revenues of the environmental tax to combatting the environmental problem, as the problem itself should be solved by the price increase. Such conclusion is, however, less convincing in practical terms. Levying taxes on certain environmentally harmful products without directing them back to combat the initial environmental problem can lead to unwanted side effects, such as consumers crossing borders to buy non-taxed products. This would not be coherent with the objective of protecting the environment – environmental harm would only cross borders to the next Member State. Neither would it be desirable considering the combating of harmful tax competition, as Member States might be compelled to not introduce environmental taxes in order to receive consumers from neighbouring Member States.

5.3. Selectivity and Environmental Considerations in Taxation

5.3.1. Varying Natural Conditions and Regional Environmental Taxes

Although selectivity can also result from the geographical limitations of a tax measure,[303] regional authorities may adopt differing tax measures under the conditions discussed in Chapter 4.5.2 without it amounting to State aid. As the natural environments can vary significantly from one region to another even within one Member State, and given that some Member States have delegated environmental taxation powers to regional authorities,[304] it is quite conceivable that the defence of '*regional tax*' would be used particularly in cases concerning environmental taxation. Moreover, some pollutants, so called non-uniformly mixed pollutants, are specifically connected to their region so that their impact is different depending on the place of emission. In such cases regional differentiation of environmental taxes is particularly justifiable.[305] Decentralising *environmental* taxation powers to regional authorities also seems legitimate as it would allow the authorities to profit from local knowledge about the region's environmental conditions when determining tax rates and measures.

To shortly reiterate the defence of regional taxes, it entails that a sufficiently autonomous region can apply its own tax measures whereby the frame of reference in the selectivity-test must be confined to the region and not the entire Member State. Put in other terms, a measure can be regionally general, whereas it would be selective if assessed in the context

[303] Case T-308/00 *Salzgitter* [2004] ECR II-01933, para. 38. This conclusion was not changed in the appeal, *see* case C-408/04 *P Salzgitter* [2008] ECR I-02767, para. 109.
[304] Määttä 1997, 27
[305] Määttä 2006, 45

of the entire Member State.[306] The ECJ has defined sufficient regional autonomy as consisting of three dimensions of autonomy which must all be present - *institutional, procedural and economic autonomy.*[307]

In my reading, the ECJs assessment of these three dimensions includes no mentioning of whether or not the autonomy of the region is to be determined based on its autonomy as regards each measure separately, or the autonomy of the regional as a whole. The relevance of this distinction for environmental taxes is that a region might be given more extensive powers and autonomy in relation to its environmental policy, whereas other policies would be to a larger scale financed and governed by the central authorities. In my opinion, it would seem an unnecessarily strict approach to environmental taxation to require that the region must be sufficiently autonomous in general and not only when it comes to defining environmental taxes. This line of argumentation seems to be consistent with that of *Micheau*, who points out that '*what matters in tax matters is the autonomy enjoyed by the region to confer the tax regardless of other economic or political considerations*'.[308] Concerning economic autonomy, the ECJ seems to have applied this approach, as the autonomy test does not require than no financial connections exist between the region and the State.[309] Instead, the ECJ has emphasised that economic autonomy would requires that potential losses incurred by the region due to its own implementation of the tax regime would *not* be reimbursed by the state.[310] In the case of *UGT-Rioja* concerning the regional autonomy of the Basque Country, the ECJ underlined that any financial transfers between the State and the region would not per se exclude economic autonomy, but that the compensation should be specifically directed at the tax losses incurred.[311] The State can continue to support the region economically, as long as there is no causal connection between the amounts transferred and the losses incurred by the region.

The above reasoning would also seem reasonable when considering the ECJs and the Commission's capacity to assess constitutional relationships between regions and central governments. A more limited approach, where autonomy is assessed only in relation to

[306] Bacon 2009, 87
[307] Case C-88/03 *Portugal v Commission*, [2006], ECR I-07115, para. 70, also joined cases C-428/06 to C-434/06 *UGT-Rioja* [2008] ECR I-06747,75 and 87
[308] Micheau 2011, 207
[309] *See* joined cases C-428/06 to C-434/06 *UGT-Rioja* [2008] ECR I-06747, paras 123-140
[310] *See e contrario* case C-88/03 *Portugal v Commission* [2006], ECR I-07115, paras 71
[311] Joined cases C-428/06 to C-434/06 *UGT-Rioja* [2008] ECR I-06747, paras 123-140

environmental policy would seem to be less intrusive on the Member States' constitutional law. However, in the *Azores* –case the ECJ assessed concepts of Portuguese constitutional law. It specifically pointed at the local authority adopting the taxing having to have a separate political and administrative status from a *constitutional* point of view in order to meet the condition of institutional autonomy.[312]

Moreover, in the assessment of the regime in the Azores, the ECJ referred to '*national solidarity*', a general constitutional principle in Portugal, as one of the factors taken into account when assessing the autonomy of the region. The ECJ referred to the Portuguese legislation according to which the principle entails *inter alia* that the central State contributes, together with the regional authorities, to the correction of inequalities deriving from remoteness of the region.[313] On the contrary, there was no mentioning of the contested tax measure being reimbursable by the state, as the ECJ confined itself to pointing out that the Portuguese Government had not demonstrated that State financing was not going to be used to cover for the reduced tax revenues resulting from the tax measure adopted by the Azores authorities.[314] Such argumentation could imply that the constitutional status of a region must meet the conditions of autonomy on a *general level* and not only in relation to a certain tax measure. This approach taken by the ECJ would seem rather formalistic, and in addition it is can be perceived as intruding into Member States' constitutional orders, in contrast with the obligation to respect Member States constitutions as set out in Article 4(2) TEU.[315]

Naturally, one could argue that unless interpreted strictly, regions may be delegated with the right to impose indirect environmental taxes specifically in order to circumvent the application of Article 107(1) TFEU. As opined by Advocate General *Geelhoed*, Member States may be inclined to give formal autonomy to regions, while retaining actual power. Assessing geographical selectivity based on formal autonomy would be in contrast with the prevailing effect principle in State aid control.[316] A far reaching differentiation of environmental taxes between different regions could also lead to further difficulties in pursuing common European environmental goals as well as intensified environmental tax

[312] Case C-88/03 *Portugal v Commission*, [2006], ECR I-07115, para. 67
[313] *ibid.*, para. 72
[314] *ibid.*, para. 71
[315] Micheau 2011, 206
[316] Opinion of Mr AG Geelhoed of 20 October 2005 in case C-88/03 *Portugal v Commission* [2006] ECR I-07115, para. 59

competition. However, I find it questionable how realistic such development would be when it would presuppose that Member States make significant changes to their constitutional systems governing regional autonomy. Certain areas are already autonomous enough to fulfil the criteria, and given the local nature of environmental questions, I find that a light loosening up of the regional autonomy criterion would be welcome.

Some systems of regional variation of taxes are not considered as State aid despite the regions being economically dependent on the central government, and thus not autonomous. An example of this it the Italian landfill tax, which is determined at a regional level. Each region applies its own system of tariffs based on different variables such as whether the waste has been pre-treated and whether the recycling targets have been met, while nevertheless adhering to nationally defined targets, bans and restrictions.[317] The regional authorities have specifically been designated the task of forming their own waste tax regime, albeit within the margins and targets set on a national level. Since all regions define their own tax rates, the devolution of tax powers regarding environmental taxes is *symmetrical*. Some undertakings will benefit from being established in a certain region, but that does not necessarily mean that they are conferred an advantage in the sense of Article 107(1) TFEU.[318] This is in line with the situation described by the ECJ, where the allocation of taxation powers corresponds to a model for distribution of tax competences in which all the local authorities at the same level have the autonomous power to decide the tax rate applicable within their territory, albeit within limits set at a national level. The ECJ stated that such a situation would not be selective because no 'normal' rate could be established as a frame of reference.[319] Member States' systems of parallel regional tax competences are thereby not selective and thus not at variance with State aid control.[320]

However, as to *asymmetrical* devolution of taxation powers selectivity, selectivity is easily fulfilled. For instance, in Finland the landfill tax is determined separately for the Åland Islands and for the rest of the country. It is not self-evident whether the requirements for regional autonomy as established by the ECJ in the *Azores* case – institutional, procedural and economic autonomy, can be fulfilled when the regional powers are differentiated asymmetrically for only or a few regions. As regards the idea of varied natural conditions being the basis for allocating environmental taxation powers to certain regions, it would be

[317] Commission Roadmap for South Italy concerning municipal waste management performance, 3
[318] *See* Micheau 2011, 205
[319] Case C-88/03 *Portugal v Commission*, [2006], ECR I-07115, para. 64
[320] Quigley 2012, 114

reasonable to accept also asymmetrical systems for regional environmental taxation. Institutional autonomy is perhaps the clearest conditions, By analogy of the ECJ's interpretation in *Gibraltar*, the fact that a certain region would have the power to set its own rates on environmental taxes within limits set at a national level should not amount to selectivity only because they depart from the taxes in the rest of the Member State.

An important difference between *Gibraltar* as well as *Azores* and environmental taxes is, however, the cases concerned direct taxation. As direct taxation falls within the sole competence of Member States, it is perhaps more natural to allow for Member States to decide upon the devolution of tax powers in that situation than when it comes to indirect taxes, such as environmental taxes. This observation is particularly relevant when it comes to the assessment of procedural autonomy, entailing that central government should be able to intervene directly as regards the context of a tax proposal. In *Gibraltar*, the condition was considered to be fulfilled since company taxation fell within Gibraltar's competence.

Moreover, the UK had never in reality made use of its existing constitutional powers to intervene directly into Gibraltar's policy decisions in matters relating to 'financial and economic stability', a notion which would seem to include taxation.[321] Procedural autonomy regarding indirect taxes is somewhat less apparent. In the field of indirect taxes the competence is shared between Member States and the EU and new rules or regulations concerning indirect environmental taxes on an EU level cannot be departed from at a regional level. One could view this as meaning that 'direct intervention' into a region's tax policy on indirect environmental taxes is possible by definition, whereby the condition of procedural autonomy may not be fulfilled. This, of course, is not the case for the Finnish Åland Islands or Gibraltar for that matter, since they are both excluded from the fiscal territory of the EU.[322]

5.3.2. Can Environmental Objectives be Inherent to the Tax System?

Apart from geographic selectivity, an environmental tax can naturally be materially selective. A national environmental tax measure which favours certain undertakings or the production of certain goods in comparison with others which, in the light of the objective

[321] Cases T-211/04 and T-215/04 *Gibraltar* [2008] ECR II-03745, paras 91-93. This part of the decision was not changed by the ECJ judgment on the appeal.

[322] Article 2 ACT concerning the conditions of accession of the Kingdom of Norway, the Republic of Austria, the Republic of Finland and the Kingdom of Sweden and the adjustments to the Treaties on which the European Union is founded, Protocol No 2 - on the Åland islands, OJ C 241, 29.8.1994, p. 352, and Article 6 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

pursued by the tax, are in a comparable factual and legal situation is considered selective.[323] Moreover, as an exception to the aforementioned definition, a tax measure shall nevertheless not be considered selective, if it is inherent to the tax system and therefore passes the system test. The system test entails that the tax measure adheres to the general tax system in the Member State and is a direct consequence thereof. The assessment of material selectivity and it's possible justification through the system test is somewhat different when it comes to

a) national tax measures which aim at environmental protection, than when it comes to

b) derogatory tax measures which are introduced to *reduce* environmental taxes in order to achieve other objectives, may they be related to competitiveness, social concerns or something else.

First, a distinction between two types of justifications should be made. It has been pointed out by scholars that justifications which are acceptable under the system test, so called internal justifications, are different from policy-related justifications, which are external to their nature.[324] Therefore, there is a distinct difference between *the nature of the tax system* on the one hand, and the *specific environmental objectives* of a tax measure on the other. It has further been held that *only* the previous kind of justifications such as for instance progressivity of a tax can justify a selective measure, or rather; render a measure 'unselective' so as to escape Article 107 entirely. This interpretation is most relevant when assessing tax measures belonging to group a) referred to above, that is, tax measures intended to reduce environmental harm. According to this view, external justifications such as environmental objectives should not be taken into account as justification. Such interpretation is in line with the wording used by the ECJ's in *British Aggregates.* In said case the ECJ stated that environmental objectives are taken into account to sufficient extent under Article 107(3) TFEU, whereby consideration under Article 107(1) TFEU is unnecessary.[325]

[323] Joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, para. 75. *See also* case C-88/03 *Portugal v Commission*, [2006], ECR I-07115, para.54; case C-172/03 *Heiser* [2005] ECR I-01627, para. 40; case C-308/01 *GIL Insurance* [2004] ECR I-04777, para. 68; case C-143/99 *Adria-Wien* [2001] ECR I-8365, para.41.
[324] Quigley 2012, 118
[325] Case C-487/06P *British Aggregates* [2008] ECR I-10505, para. 92. See for similar reasoning in a case concerning car loans granted to SMEs and self-employed persons with the objective of renewal of the commercial vehicle fleet in Spain, case C-409/00 *Spain v. Commission* [2003] ECR I-1487, para. 54.

Of course, one could imagine that environmental concerns are so integrated in the national tax system that are guiding principles of that system in the same way that progressivity, for instance. In that case, the environmental justification would be "internal" and therefore pass the system test. However, since very few or no Member States could argue that environmental objectives are inherent in the nature of their tax system,[326] one must ask whether it is possible at all to introduce environmental taxes without them being considered selective.

Nevertheless, the ECJ has not been consistent as to the above assessment of selectivity. The Commission and the ECJ have occasionally departed from the view expressed in *British Aggregates* and assessed selectivity specifically in light of the pronounced objectives of the national law. This approach is coherent with the definition of State aid referred to above, where different treatment of undertakings in the same situation should be assessed 'in light of the objective pursued' – *e.g.* environmental objectives. The ECJ's approach has been interpreted as permissive as regards taxes which conform strictly to the PPP.[327]

This approach to selectivity is particularly relevant when it comes to derogatory tax measures under group b) that is derogations from environmental taxes on the basis of other than environmental objectives. There is, however, still uncertainty as to whether the objectives pursued by the tax in question should have an impact on the assessment material selectivity or not. Even the Commission does not seem certain of whether it should be taking environmental objectives into account when assessing selectivity of tax measures. For instance, in a decision concerning a Dutch zero-rate of energy tax on renewables, the Commission first stated that the tax measure did not constitute aid, since it was in line with the environmental objective of the tax. However, the Commission stated that in the alternative, the tax would in any way be permissible under Article 107(3)(c) TFEU.[328] In a subsequent State aid case, the Commission relied strictly on the ECJ's wording in previous

[326] With the possible exception of Denmark and the Netherlands, where the revenue generated by environmental taxes is the highest in the EU, and who also use a larger variety of environmentally incentivising taxes than others, see OECD 2010, 33-34, 36 and 44 and Taxation trends in the European Union: Data for EU Member States, Iceland and Norway, Eurostat, European Union 2012.
[327] Hancher – Salerno 2011, 260
[328] See e.g. Commission decision C (2001) 3752 final, Netherlands: Zero rate for green electricity (NN 30/B/2000 and N 678/2001), 28 November 2001, 5

case law[329] and held that subjective aims of the national legislator have no bearing in the selectivity test.[330]

Assessing selectivity and justifications in light of the objective pursued would allow for a more convenient approach to Member States wishing to pursue national environmental policies by means of taxes. However, if taking national environmental objectives into account in the assessment of selectivity, one must be aware of the fact that the outspoken objectives might not be the same ones as the actual objectives. An outspokenly environmental tax measure might in fact be designed to conceal State aid. On the other hand, when a tax measure applies incoherently as regards its objective, for instance so that it treats foreign polluters worse than domestic polluters, it can be rather straightforward to identify that the measure is selective. In such a case the effects of the measure are not in line with its alleged objectives, whereby the measure can be deemed selective.[331] In its decision concerning an exemption from passenger tax on airlines in transit, the Commission noted that despite the tax being labelled as having environmental aims, the actual objective was fiscal. Consequently, the selectivity test was applied in light of the fiscal aims of the tax.[332]

Nevertheless, arguing that environmental objectives should never be taken into consideration when assessing selectivity is consistent with the argument of selectivity being as little about the objectives of a tax as it is about the form in which the tax is imposed. Instead, as mentioned repeatedly by the ECJ, the *effects* of a measure should determine how it is perceived in the selectivity test.[333] Moreover, as stated by the ECJ, environmental concerns may, in any event, be taken into account as to the permissibility of the State aid measure pursuant to Article 107(3) TFEU.[334] On the other hand, it seems that restricting the Member States from adopting new tax policies without notification, notably such that involve environmental concerns, is quite a considerable restriction of the fiscal sovereignty of the Member States. As mentioned earlier, the exceptions awarded by virtue

[329] Case C-222/04 *Cassa di Risparmio* [2006] ECR I-00289, para. 137
[330] Commission Decision C (2009) 7375 def., Czech Republic: Income tax exemption on awards and donations in the cultural sphere (State aid NN 44/2007 (ex N 32/2006)), 30 September 2009, paras 25-29
[331] Case C-169/08 *Regione Sardegna* [2009], ECR -10821, paras 41 and 63-64
[332] Commission Decision C (2011) 4933, Netherlands: Air Transport - Exemption from air passenger tax (SA.25254 (NN18/2009)), 13 July 2011, paras 27-28
[333] *See inter alia*, case C‑279/08 P *Commission v the Netherlands* [2011], not yet reported, para. 75; case C‑409/00 *Spain v Commission* [2003] ECR I‑1487, para. 46
[334] Case C‑279/08 P *Commission v the Netherlands* [2011], not yet reported, para. 75

of Article 107(3)(c) TFEU and the Environmental Aid Guidelines are limited as to their material and temporal scope.

Therefore, I find that external environmental justifications should be taken into account in the assessment of selectivity. This conclusion is backed up by Advocate General Geeldhoe's opinion in *GIL Insurance.* where he gave an example concerning a selective tax on environmentally friendly cars, saying that where State aid control would require that taxation for environmentally friendly cars was brought up to the level of the taxation of environmentally unfriendly cars, the Member States would be deprived of a policy instrument used to pursue a fully legitimate objective, which would in essence '*remove from the Member State concerned competences conferred on it by the Treaty*'.[335] Naturally, such tax measure could probably be allowed of notified to the Commission, but as will be shown in Chapter 5.5, creating an environmental tax which adheres to the Environmental Aid Guidelines is not uncomplicated.

5.3.3. Justified Derogations from Environmental Taxes

Following the aforementioned approach to selectivity where external objectives such as improving the environment are not taken into account, *derogations from* environmental taxes can still escape State aid control due to *internal* justifications. Internal justifications are justifications which pass the system test. According to the test, tax measures which derive from the nature of the tax system in question are justified and not selective.[336] Therefore, guiding principles such as ability to pay can justify derogations from environmental taxes, which would otherwise be construed as selective.

A guiding principle that has been approved as being inherent in the nature of the tax system is progressivity of income tax.[337] By contrast, the regressive nature of a tax has been held as an indication of selectivity. This is unlikely to apply for environmental taxes, seen that they mainly consist of indirect taxes which are typically regressive to their

[335] Opinion of AG Geelhoed of 18 September 2003 in case C-308/01 *GIL Insurance* [2004] ECR I-04777, para. 76
[336] Commission Notice on the application of the State aid rules to direct business taxation, OJ 1998 C 304/03, para. 12. The principle was first established in case 173/73 *Italy v. Commission* [1974] ECR 709, para. 15.
[337] Commission notice on the application of the State aid rules to measures relating to direct business taxation OJ C 384, 10.12.1998, para. 24

nature.[338] The regressive nature of a tax might therefore be considered "inherent in the system" when it comes to indirect environmental taxes.

Moreover, the ECJ's ruling in *Gibraltar* also suggest that the principle of ability to pay could be accepted as a guiding principle as long as it is applied consistently, which the ECJ held not to be true in that particular case.[339] According to this line of interpretation, a Member State applying a reduced tax rate of an environmental tax on undertakings with lower ability to pay would not qualify for State aid, provided that ability to pay is inherent in the national tax system as a guiding principle. At a first reading this does perhaps not seem strange at all. However, when considering the eventuality where the undertakings being more leniently taxed cause more environmental harm than those being heavily taxed, the results of such tax becomes rather dubious in light to the overall objectives of both State aid control and environmental taxation. The tax does not consist of internalising environmental costs into prices, nor does it necessarily promote competitiveness. In fact, the result seems to contradict the general national aim of the tax itself, being the protection of the environment. The same logic has been expressed by Advocate General *Kokott*, stating that it would be inconsistent with the PPP to exempt certain groups from costs incurred by the environmental pollution they cause on the ground of poverty or reduced ability to pay.[340] On the other hand, as is correctly pointed out by *Kingston*, at least the Member States' power to decide upon national tax policies is respected when allowing guiding principle of the national tax systems to escape the definition of prohibited State aid.[341]

The ECJs interpretation of the system test has been strict, which is true also for cases of aid relating to environmental taxes.[342] The strict approach was present in the frequently cited case *Adria-Wien*, which concerned a rebate scheme from electricity and natural gas taxation for manufacturing undertakings, as it was considered that the manufacturing industry would be particularly harmed by high energy taxation. ECJ kept to a strict interpretation of the selectivity by concluding, *inter alia*, that there was no evidence to determine that the industry benefitting from the rebate in question would suffer more from

[338] *See e.g.* Kosonen 2012, 1 and Määttä 1997, 210-211 and on consumption taxes in general, *see* Juanto – Saukko 2012, 8
[339] Joined Cases C-106/09 P and C107/09 P *Gibraltar* [2011], not yet reported, paras 179-180
[340] Opinion of AG Kokott of 2 July 2009 in case C-169 *Regione Sardegna* [2009] ECR I-10821, para 74
[341] Kingston 2012, 398
[342] Hancher – Salerno 2011, 254

the energy tax than other industries, whereby the tax was considered selective, although being applied similarly to *all* manufacturing undertakings.[343] In other words, the industries were in a comparable legal and factual situation with regard to the harm caused to the environment by the consumption of electricity and natural gas, whereby applying the rebate scheme to only one category of industry amounted to selectivity. The tax measure could therefore not be traced back to any guiding principle of national tax law. Whether there was a national principle according to which manufacturing industry was to be taxed differently from other industries was not addressed.

The ECJ's strict interpretation of system was reiterated in *British Aggregates*,[344] where the ECJ further narrowed the margin of discretion of Member States wishing to introduce a tax measure justified by environmental concerns. The case concerned a levy on virgin aggregates such as gravel and sand, but included a number of exemptions which were not, according to the ECJ, justifiable in neutral terms in relation to the intended environmental objective. In contrast to what the GC[345] and the Commission[346] had stated, the ECJ concluded that the tax measure was not general but selective since it did not apply similarly to all aggregate industry activities with equivalent environmental effects.[347] The national conception of what is good for the environment does not seem to have any relevance. Instead, the assessment of environmental effects is conducted by the ECJ. By generalising this conclusion one must interpret the connection between State aid and environmental taxes as a very delicate one, where all effects of different methods should be taken into account in order to apply similar tax rules on activities with equivalent effects. In other words, environmental levies must be constructed so that they are consistently environmentally friendly. Taking into consideration the fast evolvement of environmental technologies and the knowledge of the effects thereof, this could prove to be challenging for the Member States attempting to introduce environmental tax schemes.

[343] Case C-143/99 *Adria-Wien* [2001], ECR I-08365, paras 50-54
[344] Case C-487/06 P *British Aggregates* [2008] ECR II-10505.
[345] The GC had come to another conclusion, saying that Member States enjoy a certain margin of discretion when applying environmental tax schemes. The GC held that there the logic of Adria-Wien was not to be applied in the case of British Aggregates since, among other things; the first concerned an exemption from a levy, whereas the latter concerned the rate of the levy on different types of the product. See case T-210/02 *British Aggregates*, [2006] ECR II-02789, para. 120.
[346] Commission Decision C(2002) 1478 final of 24 April 2002 on state aid file N863/01 – United Kingdom / Aggregates Levy, para. 34
[347] Case C-487/06 P *British Aggregates*, [2008] ECR II-10505, para. 86

Moreover, the interpretation adopted by the ECJ might have an impact on Member State's willingness to pursue environmental goals through taxation. As pointed out by *Kingston* the ECJ's view on environmental taxes under 107 TFEU can be seen as permitting the ECJ to '*second-guess member States' choices as to how they wish to prioritise the reduction of polluting activities*'.[348] The same concern has been expressed by *Lang* in relation to the supposed change in the ECJ's application of the selectivity criteria in *Gibraltar* as well as in *British Aggregates*. According to *Lang*, the ECJ's approach may have '*important implications e.g. for taxes intended to discourage pollution*',[349] mainly consisting of Member States having to construct their environmental taxation so that all activities causing equally polluting effects also bear an equal tax burden. Different ecological methods would thus have to be taxed similarly, whenever the impact they have on the environment is the same, a requirement referred to as *technological neutrality*.[350] Creating said type of a technologically neutral environmental tax is not an easy task to impose on Member States.

5.3.4. Towards an Objectives-Based Approach on Selectivity

The above discussion proves that assessing selectivity without taking into account the objective of the tax measure – particularly in environmental cases – can lead to results which are neither in line with the environmental objectives of the EU, nor with the powers to tax that Member States have according to the Treaty. However, the previous strict approach to selectivity, making no exceptions due to environmental aims of a tax measure, has been loosened up in recent judgements, at least according to a number of scholars.[351] The wording of the GC in *British Aggregates* which had been returned to it by the ECJ certainly supports such a conclusion, stating that environmental objectives of the British aggregates levy could not be disregarded in the assessment of the similarity of legal and factual situations. Instead, selectivity was to be assessed in light of the distinct principles and objectives within the field of taxes in question.[352]

Micheau[353] has integrated the external objectives of a tax into the system test, so that the tax measure is first assessed against the external objectives, and then based on adherence to

[348] Kingston 2012, 398
[349] Lang, John Temple 2012, 812
[350] Määttä 1997, 252
[351] Nicolaides – Rusu 2012, 802; Bartosch 2010, 743
[352] Case T-210/02 RENV *British Aggregates* [2012], not yet reported, para. 68
[353] Micheau 2011, 203

the general taxation scheme of the Member State. A similar model for assessing selectivity is proposed by *Nicolaides* and *Rusu*.[354] An objectives-based approach to selectivity would approach the rule of reason-doctrine of established in relation to free movement of goods.[355] By analogy, one could argue that if the objectives approach were adopted, national tax measures should also be subjected to the proportionality-test in the assessment of selectivity. Environmental objectives could be taken into account when assessing selectivity of a tax, but the objective would have to be acceptable, adequate and not go further than what is necessary to attain the objective pursued. *Bartosch* describes the objectives-based approach as three stages in the assessment of the criterion of material selectivity:

(1) Identifying the reference framework
(2) Identifying the objectives pursued by the measure, and assessing their permissibility under State aid control
(3) Applying the system test, as in verifying that the measure together with its objectives is justified by the nature of the reference framework.[356]

The recent case of *Paint Graphos* indicated that the national court was, in fact, to consider the proportionality of the tax reduction in question when assessing whether the measure was justifiable under the system test.[357] However, there is in principle no distinct legal basis for introducing a proportionality-test into State aid control under Article 107(1) TFEU. The wording of the article states that *any* aid should be considered incompatible with the internal market. Less dramatic applications of the rule of reason-doctrine have, however, found their way into State aid control. For instance the adoption of the *de minimis*-regulation has been considered to mitigate the strictness of the interpretation of Article 107(1) TEEU as it permits for aid measures which fall below the threshold values set in the regulation without notification. In that way it is an expression of the rule of reason-approach.[358]

In my opinion, the objectives-based approach could be welcome change in the interpretation of selectivity. The objectives of internalising environmental costs and

[354] Nicolaides – Rusu 2012, 792
[355] The doctrine was first recognised in the famous *Cassis de Dijon*-case, 120/78 *Rewe-Zentral* [1979] ECR 649.
[356] Bartosch 2010, 739
[357] Case C-78/08 to C-80/ *Paint Graphos* (C-80/08) [2011], not yet reported, para. 75
[358] Raitio 2010, 600. See also Chapter 6.4.1 on the *de minimis*-regulation.

allowing for sustainable growth while maintaining competitiveness could be reached if Member States had more possibilities to adopt national environmental taxes without the burden of notifying the measure. Moreover, the risk of distorting competition, or having Member States introduce protectionism measures would be reduced by requiring that the measures pass the proportionality-test. Many of the more recent cases relating to State aid and taxation which have already be decided upon would in my interpretation *de facto* result in a similar conclusion if applying an interpretation in line with the objectives-based approach. However, the Member States would be better equipped to pursue environmental policy by fiscal means since they would no longer be bound by the '*system test*' as the only possible defence from selectivity, but could invoke environmental objectives as long as those were applied in coherence with the national taxation scheme. Otherwise, national tax policy could only pursue general tax principles, such as progressivity or ability to pay, without notifying the aid to the Commission.[359] Such an approach would not further Commission's efforts to promote the adoption of national environmental taxes as market based instruments.

5.4. Liability to Distort Competition and Effect on Interstate Trade

5.4.1. Aiding Local Environment – No Competition in Sight

The last criterion to be assessed is that of liability to distort competition and effect on interstate trade, as discussed in Chapter 3.5. Limited aid to local service can in principle escape this criterion.[360] With the exception of measures which fall within the scope of the *de minimis*-regulation, the Commission has only rarely concluded that a measure would not be liable to distort competition nor affect interstate trade. Out of those measures none have been fiscal or related to environmental concerns.[361]

Instead, the aid measures which have not, according to the Commission, amounted to State aid, have been SGEI services related to local projects which faced no competition. In comparison, limited tax exemptions on specific local environmental grounds could at least in principle not affect competition, and therefore be acceptable under Article 107(1) TFEU.

[359] Bartosch 2010, 743
[360] Twenty-Sixth Report on Competition Policy (1996), 230
[361] Commission staff working document, COM (2007) 725 final, p. 12. See also Commission Decision in case NN 29/02 – Spain – Aid for the installation of service areas on Tenerife OJ C 110, 8.5.2003; Commission Decision in case N 543/2001 – Ireland – Capital allowances for hospitals OJ C 154, 28.6.2002 and Commission Decision in case N 258/2000 – Germany – Leisure Pool Dorsten, IP/001509 of 21/12/2000 OJ C 172, 16.6.2001

In Finland one could argue that the fact that peat and pine oil are not subjected to a strategic stockpile fee[362] is an aid which does not have an effect on Member State trade due to the scarcity of those particular raw materials elsewhere in Europe, whereby competition within that field is non-existent. Moreover, as has been expressed by Advocate General Jacobs, small amounts of aid to sectors operating on local markets such as car repairs, taxi services or sectors with prohibitive transport costs might not be liable to affect trade between Member States.[363] Thus, there might be a possibility of introducing or reducing levies on a local level.

The registration tax for passenger cars in Finland, which is normally based on CO2 emissions registered for the car model provides for a practical example in this context. [364] The registration tax includes a derogation for passenger cars used in taxi services, for which the tax payable is reduced.[365] According to the reasoning of Jacobs, the reduction for taxis could be considered as not having an effect on Member State trade, whereby it would not constitute State aid. Having said that, minor effects on trade between Member States could, however, be produced in bordering regions to other Member States, where it might be profitable to register taxi cars on one side of the border despite providing the taxi services mainly on the other side of the border. Whether or not minor and rather unlikely effects on trade like the one described here could be considered as fulfilling the criterion is not entirely clear from the Commissions practice. To my knowledge the exemption has not been notified to the Commission.

5.4.2. Does Taxing at the Destination Exclude Effects on Interstate Trade?

One of the most important environmental taxes is the VAT, which is harmonised throughout the EU, but which allows for member States to diversify the rate applied.[366] Despite that, the compatibility of national VAT measures with the rules concerning state aid have been examined only very rarely by the ECJ, and a VAT measure has been deemed

[362] The strategic stockpile fee is imposed on coal, natural gas and equivalent fuels (see Section 2a of said act) as well as electricity in different rates. See the Appendix Table of the Act on Excise Tax on Electricity and Certain Fuels (30.12.1996/1260).
[363] Opinion of Mr AG Jacobs delivered on 30 April 2002 in case C-126/01 *GEMO* [2003] ECR I-13769, para. 145
[364] Section 6 of the Finnish Act on Car Taxation (29.12.1994/1482)
[365] Section 28 of the Finnish Act on Car Taxation (29.12.1994/1482)
[366] Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tax policy in the European Union - Priorities for the years ahead, 23.5.2001, COM (2001) 260 final, 12

to constitute State aid only once.[367] The same can be said about excise taxes, with the exception of the frequently cited case *Adria-Wien*, which concerned an energy tax rebate system for undertakings in the manufacturing business.[368] The question of whether reduced VAT or excise can be liable to distort competition in the meaning of Article 107(1) has thus not yet been thoroughly evaluated by the ECJ.

As to tax relief on taxes such as the VAT and excises, which are based on the *destination principle* where the tax is collected at the place of the consumer, it is questionable whether trade between Member States would be affected in the meaning of Article 107(1) TFEU at all. As has been mentioned earlier, the criterion of liability to distort competition and affect interstate trade is normally easy to fulfil, even in tax cases, the vast majority naturally being cases concerning direct taxation. In relation to direct taxes, it has been established that even tax relief which is available for *all* national undertakings within the relevant market must be prohibited if the national undertakings compete with undertakings from other Member States.[369] This is because such tax relief would discourage non-national undertakings from exporting their products to the Member State applying the tax relief.[370]

However, since VAT and excises are normally levied in the destination state, foreign undertakings will not be discouraged from exporting their products to the Member State applying a higher VAT or excise on the products in question. Consequently, whereas indirect taxes following the *destination principle* are concerned, liability to distort competition and interstate trade is logically present only when there are other substitutable products available, which do not benefit from the tax relief. This reasoning has been relied on by the Commission in cases concerning excise duties on biofuels. Since biofuels serve as a substitute for fossil diesel and petrol, tax exemptions and reductions for biofuels are

[367] *See* Terra 2012, 101 and case C-172/03 *Heiser* [2005] ECR I-1627. An additional case where a VAT measure has been deemed to constitute State aid has been judged upon by the EFTA Court, *see* the EFTA Surveillance Authority Decision No 155/07/COL of 3 May 2007 on State aid granted in connection with Article 3 of the Norwegian Act on compensation for value added tax (VAT) (Norway), OJ L 249, 18.9.2008, p. 35–46
[368] Terra 2012, 102. See case C-143/99 *Adria-Wien* [2001] ECR I-8365.
[369] Case C-66/02 *Italy v Commission* [2005] ECR I-10901, paras 115 and 117; Joined cases C-393/04 and C-41/05 *Air Liquide* [2006] ECR I-5293, para. 55
[370] Case C-280/00 *Altmark* [2003] ECR I-07747, paras 77-79.

liable to distort competition on the Internal Market.[371] As a general rule, only '*internally distortive*' indirect tax relief is liable to distort competition.[372]

Exceptionally, even neutral indirect taxes could distort competition and interstate trade, notably where consumer mobility cross Member State borders is significant.[373] An example of such a situation would be the border area of Northern Ireland, where petrol and diesel duties are significantly higher than those applied in Ireland, which causes consumer leakage from Northern Ireland to the Republic of Ireland.[374] Another example susceptible to have cross border effects is waste levies, as waste handlers may be motivated to transport waste across the border to a Member State applying a lower or no waste levy. In such cases, the trade between Member States will definitively be affected, and potentially even lead to harmful tax competition between neighbouring Member States.

5.5. Permissible Fiscal Aid for Environmental Protection

5.5.1. Environmental Taxes under the GBER

Aid which meets the criteria set by Article 107 TFEU can be declared compatible with the Internal Market by the Commission. Pursuant to the standstill obligation in Article 108(3) such aid must be notified prior to adopting the aid measure. Since the main concern in this dissertation has been whether or not taxes which the Member States have adopted without notifying it to the Commission in advance, the fact that environmental taxes could be permissible if only they were notified has not yet been discussed. Presenting when aid can be accepted by the Commission following notification illustrates the scope of the applicable exceptions. The notification procedure is not a simple rubber stamp on Member States environmental tax measures, but limits the possibilities of adopting environmental taxes in many ways. It is also true that the Commission's efforts for greening State aid law have principally been realised through the Environmental Aid Guidelines and the R&D

[371] Commission decision C (2010) 2219, Bulgaria: Tax reduction for biofuels, 09.04.2010 (N 607/2008), para. 29 and commission decision C (2011) SA.26798– Italy: Application of Directive 2003/96/EC on restructuring the Community framework for the taxation of energy products and electricity – Excise duty exemption for vegetal oil (N 529/08), para. 24
[372] Englisch 2013, 16
[373] ibid., 17
[374] Convery et.al. 2007, 4

Framework for environmental taxes aimed at creating incentives for innovation,[375] which do not relate to the application of Article 107(1) TFEU but to aid which is permissible despite not being compatible under said Article. Therefore, it is reasonable to take a brief look into the types of aid that does constitute State aid under Article 107(1) TFEU, but that can be declared compatible with the Internal Market after having been notified to the Commission pursuant to the procedure set out in Article 108(3) TFEU.

The GBER, alongside with the *de minimis*-regulation discussed above, differs from the other exemptions from Article 107(1) TFEU in the sense that it allows Member States to adopt certain environmental tax measures without fulfilling the notification procedure set out in Article 108(3) TFEU.[376] Measures adopted under the GBER need only to be published in the OJ and the aid scheme must include an express publication reference to the OJ.[377] Environmental Tax measures which have been published in the OJ pursuant to their compatibility under the GBER include various types of tax relief, mostly related to rebates, reductions and exemptions from excises on energy and electricity. The less typical examples the State aid communicated by Member States the abatement from the Danish sulphur tax.[378]

The on-going project for the Modernisation of State Aid aims on extending the scope of measures which would be allowed under the GBER, which would add to the efficiency of State aid control.[379] From the perspective of the Member States, it would be a welcome addition to the GBER if the permissibility of fiscal measures for environmental protection would be more detailed in the GBER so as to allow for the development of environmental taxation without the burdensome procedure of notifying measures to the Commission in advance.

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[375] Communication from the Commission - Community framework for State aid for research and development, OJ C 323/1 of 30.12.2006, hereinafter '*R&D Framework*'. See for more on environmental taxes and innovation OECD 2010. In specific cases also the Community guidelines for state aid in the agriculture and forestry sector 2007-2013 (OJ C 319 of 27.12.2006) may become applicable for fiscal aid for the environment, but due to the delimitations of this study they shall not be further assessed in this dissertation.

[376] The GBER has been enacted pursuant to Council Regulation 994/98/EC, empowering the Commission to declare certain categories of aid compatible with the common market, including aid for the protection of the environment.

[377] GBER, Article 3(1)

[378] See SA.36120 (13/X), Denmark: Bundfradrag i svovlafgiften OJ C/128/2013, p. 41-42, 23 January 2013 and for the amending act see Lov om ændring af lov om afgift af svovl, nr 1256 af 18/12/2012.

[379] Consultation paper on Environmental and Energy Aid Guidelines 2014-2020, 9

5.5.2. Automatically Permissible Aid

If the aid measure neither falls within the scope of the *de minimis*-regulation nor the GBER, the tax aid can still be declared compatible with the Internal Market if it is notified to the Commission in advance. The Commission considers some types of aid as automatically compatible with the Internal Market, namely social aid granted to consumers, aid to repair damages of natural disasters or exceptional occurrences and aid to the German regions which suffered from the division of Germany. These grounds are listed exhaustively in Article 107(2) TFEU, and as exceptions to the general principle they must be interpreted narrowly.[380]

On a first reading one could draw the conclusion that indirect tax relief from environmental taxes could fall within the scope of Article 107(2)(a) TFEU as being '*aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origins of the products concerned*'. Tax relief from environmental taxes directed to underprivileged consumers could meet the description.[381] As to indirect taxes, the '*social character*' of the aid could for instance be justified if the indirect tax relief is aimed at household electricity, since electricity costs are normally relatively higher for low-income households. Further, a certain part of indirect tax relief is transferred to the final consumer, which would correspond to the wording of Article 107(2)(a) TFEU. Nevertheless, the textual interpretation of the provision, saying the aid must be granted *'to individual consumers*' could be considered to exclude the possibility of indirect tax relief being considered as acceptable under said Article.

As I discussed in the Chapter concerning the '*dilemma of the recipient*' of indirect tax relief, an aid which is granted directly to consumers might fall outside the scope of Article 107(1) TFEU entirely, since the recipient is not an '*undertaking*'. In such a case the exception in 107(2)(a) would certainly seem superfluous. However, as the matter is not yet settled, the Commission and the ECJ might consider that indirect tax advantages do constitute State aid even when conferred to consumers. In such a case the exemption in Article 107(2)(a) TFEU would become relevant as a ground for permitting indirect environmental tax relief granted to consumers.

[380] Quigley 2009, 127
[381] This type of tax relief could be classified as a '*harmful subsidy*' as explained in Chapter 2.2.2

Regarding the exemption for aid being granted to individual consumers, the Commission has interpreted that aid which is granted to air passengers *indirectly* through airlines can be permitted under Article 107(2)(a). The case concerned an aid to vulnerable passenger groups, such as students, pensioners and handicapped persons for tickets on the flight route between Paris and Corsica. The aid was allocated by reimbursement to all airlines operating the route from Paris to Corsica upon verification for each passenger eligible for the reimbursement.[382] The Commission stated that although the aid was not paid directly to the consumers, the reimbursement system was a practical way of distributing the aid without undermining its cause.[383] In contrast to this, aid granted indirectly through the *employer* of an individual has been interpreted as not being permissible aid to individual consumers as given in Article 107(2)(a) TFEU, but as an indirect advantage to certain undertakings.[384]

When interpreting indirect tax relief in light of the above examples, indirect tax relief would in my opinion seem closer to the case of aid to the Corsican air passengers than to that of aid being allocated via employers. The most pertinent difference between the indirect tax relief and the direct subsidy for airline tickets is perhaps that the aid to passengers to or from Corsica concerned a distinct sum of money – EUR 41 per customer and flight.[385] This can have made the reimbursement system somewhat more transparent in the Commission's view than the passing on of indirect taxes, even if the passing on is made mandatory. Moreover, despite it not being mentioned expressly in the Commission's evaluation, it seems to me that the lack of competition played a significant role in determining the Corsican aid compatible with the Internal Market. The distance from Paris to Corsica is such that other forms of transportation than flying do not amount to substitutable service. Had there been train transport, for instance, which would be substitutable with flying, the aid would potentially have been considered as benefitting the airlines and not the consumers after all. In particular case of air transport, however, the GC has in another decision taken the view that train and air transport are not substitutable with each other.[386] In more general terms I believe the existence of substitutable goods or services would amount to '*internal distortion*', whereby the Commission would find that

[382] Commission decision C (2003) 663, France: Régime d'aides individuelles à caractère social - desserte aérienne entre Paris et la Corse 5.3.2003 (N 26 / 2003), paras 9-10
[383] *Ibid.*, para. 21
[384] Nicolaides et.al. 2005, 32
[385] Commission decision C(2003)663, France: Régime d'aides individuelles à caractère social - desserte aérienne entre Paris et la Corse 5.3.2003 (N 26 / 2003), para. 7
[386] Case T-351/02 *Deutsche Bahn* [2006] ECR II-01047, para. 138

indirect tax relief is in fact granted to the undertakings and not the consumers, because reduced prices will attract clients away from the using the substitutable service or good and consequently increase the market share of the undertakings whose customers receive the tax advantage.

One could conclude that tax relief from environmental taxes might be permitted under Article 107(2)(a) TFEU, provided that *i)* it is of social character, *ii)* the passing on of the tax relief can be monitored sufficiently, leaving no doubt to the Commission to think that the aid will in fact favour the undertakings instead of the consumers, and *iii)* there is no substituting product or service available, which does not benefit from the tax exemption.

5.5.3. Aid in Accordance with Article 107(3)(c)

The Environmental Aid Guidelines provide for detailed guidelines on which types of environmental aid can be considered compatible with the common market within the meaning of Article 107(3)(c),[387] which allows for aid to '*facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*'. The measures which can be permitted under said Article also include fiscal aid.[388] Fiscal aid in the form of tax exemptions and reductions must, however, not undermine the environmental objectives pursued by the legislation in question, nor may they fall below the minimum levels of harmonised taxes, such as excises.[389] The Commission may declare a measure compatible with the Internal Market, if the tax measure is necessary and proportional. Aid which meets all of the following three criteria shall be considered necessary:

i) the choice of beneficiaries must be based on objective and transparent criteria, equal to all competitors in a similar factual situation
ii) the environmental tax without reduction must lead to a substantial increase in production costs for each sector or category of individual beneficiaries, and
iii) those costs cannot be passed on to customers without sales being significantly reduced.

To comply with the requirement of proportionality, the Commission has outlined several different means of fulfilling the criterion. According to the first option, the tax relief is

[387] Environmental Aid Guidelines, para. 12
[388] *Ibid.*, para. 151
[389] *Ibid.*, para. 152

proportionate if it is broadly equivalent with the environmental performance of the beneficiaries, which cannot exceed the part of the costs of the environmental efforts, which cannot be passed on the consumers. The second option is that the reduced tax amounts to at least 20 % of the national tax and the third option entails that the undertakings receiving the tax aid must conclude an agreement on environmental targets with the Member State which essentially leads to the same effect as is if options one or two were applied, or it the minimum level of tax set by EU law were to be applied.[390]

In Finland's answer to the Commission's consultation on the renewal of the Environmental Aid Guidelines, it is pointed out that as to entirely national taxes, the conditions for applying such a tax are nearly impossible to comply with.[391] Moreover, national environmental taxes do not, in the view of the Finnish Government, as a rule distort competition in the Internal Market as any purely national tax would only add to the tax burden of national undertakings, whereas undertakings from other Member States would not be subjected to the tax. Therefore, in Finland's view, the assessment hould be different for harmonised taxes (where the national tax level is below EU minimum) and for entirely national taxes. [392]

The conclusion of national taxes not being distortive is, however, not entirely convincing in light of the different types of environmental taxes which may be applied nationally. The example used by the Finnish government is waste tax; however, even waste taxes can become a burden on non-domestic undertakings. For instance, a waste tax measure which is constructed as a closed system could be distortive. For instance in the case concerning the French animal waste service, the tax to finance the aid was paid by the retailers, but it benefitted slaughterhouses and farmers who were consequently able to dispose of animal waste for free.[393] As a consequence, meat products of foreign slaughterhouses and farmers who would not benefit from the animal waste service were put in a less favourable position than those of national undertakings. Their products are subjected to the tax, but they do not benefit from the aid. On the other hand, when it comes to waste taxes which are not

[390] Environmental Aid Guidelines, para. 159
[391] See for an example of the Commission's assessment of an exemption from a national waste tax: Commission decision C (2009) 8099 final (ex N 328/2008), Denmark: Tax exemption for waste from cement production, 28 October 2009
[392] Summary of the main points of Finland's answer to the public consultation on Environmental Aid Guidelines, Ministry of Employment and the Economy, 12.11.2012, 6
[393] Case C-126/01 *GEMO* [2003] ECR I-13769

connected to an aid measure, it is true, that in principle, the tax should not have a distortive effect on competition or intrastate trade unless it is *internally* distortive. [394]

Some examples of environmental tax measures which have been declared permissible pursuant to Article 107(3)(c) TFEU exist. However, as pointed out by the Finnish government, the Environmental Aid Guidelines are rather demanding, which can discourage Member States from adopting environmental taxes.

5.5.4. Compensation for Discharging Public Service Obligations

Pursuant to Article 106(2) TFEU, compensation for public service obligations imposed on undertakings should not be considered as State aid as long as the services are not overcompensated, provided that the measure has been notified to the Commission under the procedure set out in Article 108 TFEU.[395] The well-known set of conditions established by the ECJ in order to identify when 'aid' may be granted as compensation for SGEI were listed for the first time in the *Altmark* case. The four conditions are:

1. The beneficiary must be entrusted with a clearly defined public service mission;
2. The parameters for calculating the compensation payments must be established in advance in an objective and transparent manner;
3. Compensation must not exceed the cost incurred in the discharge of the public service minus the revenues earned with providing the service (the compensation may, however, include a reasonable profit)
4. The beneficiary is chosen in a public tender or compensation does not exceed the costs of a well-run undertaking that is adequately equipped with the means to provide the public service.[396]

Environmental aspects can be taken into account in under the fourth criterion, where environmental aspects have been part of the public procurement procedure in accordance with EU law. *Kingston* has pointed out that even where the *Altmark*-criteria are not met, the assessment under Article 106(2) TFEU can sometimes be less stringent and allow for aid to environmental public services.[397] In practice, the Commission has for instance

[394] Englisch 2013, 16
[395] See, *inter alia*, case C-172/03 *Heiser* [2005] ECR I-01627, para. 51
[396] Case C-280/00 *Altmark* [2003] ECR I-07747, para. 95
[397] Kingston 20112, 284

approved of aid to the disposal and elimination of hazardous waste as being a SGEI.[398] An example of tax measures related to SGEIs is the French 'CSPE' tax[399] intended to offset the additional costs related to expenses borne by electricity distributors (ÉDF and the local distribution companies) in relation to their public service obligations, including the obligation to buy renewable electricity. The compatibility of the CSPE with the provisions on State aid is currently being contested as a whole, and a reference for a preliminary ruling on the issue is pending in the ECJ.[400]

[398] See *inter alia* C (2002) 4686 final, N 496/2002 France: Aides à l'élimination des déchets dangereux pour l'eau, 17 December 2002, C (2002) 4819 final, N 638/2002 – Nederland: Tijdelijke inzamelingsregeling CFK en halonen, 11 December 2002 and C (2005) 1789, Commission decision 2006/237/EC on the aid measures implemented by the Netherlands for AVR for dealing with hazardous waste, 22 June 2005

[399] The 'Contribution aux charges de Service Public de l'Électricité' or the 'CSPE' currently amounts to 13,5 €/MWh.

[400] See related case: case C-262/12: Reference for a preliminary ruling from the Conseil d'État (France) lodged on 29 May 2012 — *Association Vent De Colère! Fédération nationale*, Official Journal C 243, 11.08.2012 p. 8–8 (case pending)

6. Summarising the Main Findings and Some Concluding Remarks

6.1. Permissible Environmental Taxes and the Objectives behind the Legislation

In the beginning of this dissertation I defined three main questions to be answered in this dissertation:

1) What types of environmental taxes and derogations thereof are permissible in light of the criteria for forbidden State aid in Article 107(1) TFEU?

2) How are the objectives behind State aid control and environmental policy in the EU taken into consideration in the above interpretation of environmental taxes?

3) How should national legislators take State aid control into consideration when adopting national fiscal measures to pursue environmental policy?

I shall address my two first research questions together in the following, and return to the third question in the last Chapter of the dissertation. As to the first question, one of the main findings is that only rather few, carefully designed environmental taxes escape being defined as State aid under Article 107(1) TFEU. The fact that the environmental aim itself is acceptable does not take the tax very far in the assessment of State aid. Although all four criteria expressed in the Article must be fulfilled for a measure to be considered as State aid, they are interpreted strictly, which makes it hard to escape even one of them. One could say that the definition and interpretation of State aid is successful in the sense that it is hard to circumvent.

However, the strict approach also leads to many measures being notified to the Commission, even where those measures were never intended as State aid nor have similar effects. On the other hand, there is a large variety between those environmental tax measures which actually do escape the definition of prohibited State aid. This is due precisely to the fact that it is enough that a tax measure does not meet one of four criteria for it not to be considered as State aid.

Therefore, the foregoing analysis does not result in one single model for an environmental tax which takes all aspects of State aid control into account in order to escape it. Instead, there are several ways of constructing an environmental tax measure so that will be permissible from the point of view of State aid. However, since the State aid aspect is only

one of the things which must be taken into account when introducing an environmental tax measure, some of the theoretical constructions of tax measures which could be escape the State aid criteria are not feasible in practice. Moreover, they might be in conflict with other provisions EU law. Therefore, the suggested permissible forms of environmental tax aid should be seen only as indications of what elements can be used in order to render a tax measure more compatible with the rules concerning State aid.

Nevertheless, the analysis I have conducted in this dissertation does imply that certain types of environmental tax measures which are used in Member States can escape State aid control. As discussed in Chapter 5.1, some tax measures may be held as not constituting State aid because they do not confer an advantage on an undertaking. Thus, they do not fulfil the first of the cumulative criteria of Article 107(1) TFEU. Instead of benefiting an undertaking, the benefit of the indirect tax relief goes directly to the consumer. Bringing the tax relief close to the consumer is also in line with the objectives of environmental taxes. The environmental externalities are internalised into the consumer price, and moreover, the administrative costs for undertakings should be lower for a tax measure than for direct regulation.

However, in light of empirical evidence as well as the ECJs interpretation of cases of recovery of unduly collected indirect taxes, the possibility to escape the criterion is limited. This is natural since even when passing on the entire tax relief of an indirect tax, an undertaking may benefit from an increased market share as a result of the overall price reduction. The case law implies that the passing on of a tax measure can only be used as a defence only as long as it is indisputably proven – for instance when the passing on is mandatory by law. Moreover, it must be made sure that the undertaking does not benefit indirectly from the tax relief, and the obligations to pass on the costs is followed up by accounting measures to verify that the tax relief is not kept by the undertaking.[401]

The second criterion of Article 107(1) TFEU concerns the use of State resources. Aid which is not funded by the Member State or by resources controlled by it is permitted. Taxes themselves are by definition governed by the State, but different levy like systems have been applied by associations for instance.[402] Moreover, to be considered as forbidden State aid, the tax relief must also be granted by the State, and not the EU. Environmental

[401] Commission decision C(2007) 4297 final, in State aid N715/06, Finland: Tax Exemption to Finnvera Oyj
[402] *See* case C-345/02 *Pearle* [2004] ECR I-7139

tax relief which results directly from EU law is therefore permitted.[403] The application of this exception is narrow, since only mandatory provisions EU law are concerned. It is also good to keep in mind that even when permissible under State aid control, a scheme which uses privately funded aid measures which are imposed by the State might be at variance with the rules regarding freedom to provide services, for instance. In addition, complex tariff systems financed by privately imposed levies might in my opinion become an administrative burden for the undertakings subject to it.

The third criterion, selectivity, prove to be the most crucial when assessing environmental taxes. As to geographical selectivity, *symmetrical* devolution of environmental taxation powers to regions of a Member State would normally be considered as permissible, even when resulting in different tax rates in different regions. When it comes to material selectivity, the ECJs interpretation of State aid seems somewhat rigid. This is true particularly in cases where the aid itself would improve the environment and even further objectives set by common EU policy, such as reducing CO2-emissions. Moreover, even derogatory measures from environmental taxes, such as exemptions and reductions might be profitable for the environment, since they may allow the gradual adoption of new environmental taxes while maintaining the competitiveness of undertakings.

When analysing the ECJs interpretation of selectivity, it seems that an environmental tax may be permissible under Article 107(1) TFEU only if it is *technologically neutral*. As to derogations from environmental taxes, it seems that apart from derogations which concur with technological neutrality, only justifications which pass the system test can be allowed. An example is the progressivity of a tax. Such internal justifications could be in flagrant conflict with the environmental objectives of the national tax. Even more so, they could be contrary to the PPP and the objective of internalising environmental costs, so that undertakings polluting less would actually have to contribute more. The right to adhere to the guiding principles of national tax systems is, however, an expression of the fiscal autonomy of Member State. Therefore, one can only be certain that tax measures which pass the system test by being the result of a guiding principle of national tax law are permissible.

[403] *See, inter alia*, Commission decision C (2009) 10745, SA.25172, Slovak Republic: Tax advantage applied on electricity, coal and natural gas, (NN 63/2009 ex. N 83/2008), 23 December 2009, para. 32

Other derogations, which are not directly derived from guiding principle of national tax systems, are less likely to be permitted. However, a more objectives-based approach as emerged in case law and has been defended by a number of legal scholars. Such an approach would also be better in line with the objectives of environmental taxes, such as maintaining competitiveness while promoting sustainable growth. Economic and social derogations can also be necessary in order to avoid harming the competitiveness of an industry when introducing an environmental tax. Although it is true that Member States may be inclined to resort to environmental justifications in order to conceal State aid, such circumvention could be prohibited by applying the proportionality principle, as suggested in Chapter 5.3.4. As new environmental taxes are adopted, new case law will also indicate whether the objectives-based approach has become the main approach to the interpretation of material selectivity.

As to the fourth criterion, liability to distort competition and effect on interstate trade, the most important finding is that environmental taxes do not necessarily have an effect on interstate trade, since the tax is imposed at destination. This is due to the fact that not only national undertakings profit from indirect tax relief, but also non-domestic undertakings exporting their goods to the State with more lenient taxation. Consequently, an indirect environmental tax is unlikely to produce harmful tax competition or amount to protectionism, the combating of which is one the objectives of State aid in general. Said environmental taxes should in my mind be considered *prima facie* permissible, with the exception of internally distortive taxes or for instance areas with considerable consumer mobility.

Summing it up for the first two research questions of this dissertation, national environmental tax measures can be permissible if constructed with due regard to the interpretation of the four criteria for prohibited State aid. As regards the second research question of this dissertation, it is clear from the above conclusions that national environmental taxes are more likely to be permitted if they adhere to the general objectives of environmental taxation. A tax measure that aims at a) internalising environmental externalities and adhering to the PPP, b) reducing administrative costs c) promoting sustainable growth while maintaining competitiveness and d) providing an incentive to continuous improvement of the environment, will therefore be more likely to escape either the criterion of selectivity. Moreover, the indirect nature of environmental taxes, and more

specifically the fact that they are normally taxed at the destination, makes them less infringing on the objectives of State aid control. As explained earlier on in this dissertation, differences in indirect tax rates do not induce harmful tax competition in the same way as direct taxes. Moreover, indirect taxes are less susceptible to be used as protectionist measures, precisely because they apply similarly to domestic and non-domestic undertakings.

6.2. Practical Guidelines to Introducing Environmental Taxes

The third and last issue I wanted to address in this thesis was a practical one. In the following I therefore summarise some practical recommendations as to adopting environmental taxes while adhering to the rules concerning State aid. The method of this dissertation has been legal dogmatics, whereby this last question can only be answered in very general terms. The analysis of how the criteria for State aid are assessed when it comes to environmental taxes did, however, reveal some general ideas of what should be taken into account when introducing environmental taxes.

At the outset of this dissertation; my focus on the subject of environmental taxation was on finding out what environmental tax measures can be permitted under Article 107(1) TFEU without being notified to the Commission. Nevertheless; the primary conclusion to be drawn from this dissertation is that the scope of the notification duty set out in Article 108(3) TFEU cannot and should not be avoided when introducing environmental tax measures. This is the most rational approach for a national legislator, since the interpretation of the criteria for State aid is strict. Whether the tax measures are ones that are in line with the environmental objectives of the EU, such as the PPP, or ones that reduce the tax burden of environmental taxes for purposes such as maintaining the competitiveness of certain sectors, the strictness of State aid control should not be underrated. Rightly so, since, as put persuasively by *Luja*, a strict interpretation of which types of measures should be notified is reasonable, since '*State aid contol is, by definition an area that calls for supranational supervision*'.[404]

An element which in my mind would seem more important than avoiding notification duty would be the construction of the tax measures so that it is in line with Article 107(1) TFEU. This would allow the Commission to draw the conclusion that the measure in

[404] Luja 2012, 765

question does not constitute State aid at all, even if it has been notified. In such a case, the Member State may implement the tax measure as intended and push for a more environmentally justified tax policy on a long-term basis, without being restricted by time limits set by the Commission. This way, the Member States retain the possibility to further the use of green taxes as they seem of be one of the key solutions to environmental protection while the European ETS is struggling. Moreover, by notifying a tax measure despite considering it to not amount to State aid, a Member State can considerably increase legal certainty for recipient undertakings.

On the other hand, viewed from the perspective of Member States, the notification process is one that delays the adoption of tax measures as well as renders the process of adopting taxes complicated. In my opinion, a delayed tax measure will still be worthwhile, especially if declared compatible with Article 107(1) TFEU. It would be logical that the incentivising effect of the tax measure would not be diminished even if the adoption of the measure is delayed – on the contrary, the measure might receive more attention from undertakings and media and be more effectively considered in pricing when the situation has been legally clarified.

Furthermore, when introducing environmental taxes, it is of utmost importance to adhere to the objectives of environmental taxes as expressed by the Commission: Environmental tax measures which are in line with the PPP are more likely to be considered as compatible with the internal market. As the objectives-based approach may become the main approach of the ECJ and the Commission in the assessment of selectivity of environmental taxes, it may also be wise to construct national environmental taxes so that they would pass the proportionality test. Member States should therefore strive to justify the tax measure with permissible environmental objectives and prove that the measure is proportionate in such a way that it does not confer a more important advantage on the recipient undertakings than is necessary for attaining the objectives pursued, such as the PPP or in case of reduced environmental taxes, *e.g.* preventing tax avoidance or maintaining competitiveness of a certain industry. In this way, the Member State is better prepared to justify both the *prima facie* selectivity of a tax measure and its potential restrictive effects on the free movement provisions.

Moreover, it has become evident that Member States apply different combinations of taxes, tariffs and privately funded aid together with direct regulation in order to further

environmental aims. As an example of this I presented the French closed system of imposing an environmental levy on the final consumer and then allocating the proceeds of the levy back to the same sector based on for instance social or economic policy. The model is based on the idea that environmental taxes lose their effect when accompanied by tax breaks and exemptions, which is why such taxes should be applied consistently in accordance with the environmental harm caused, that is to say in accordance with the PPP. Further, the proceeds from the tax should be allocated through a separate mechanism, which takes into account other objectives, such as competitiveness, regional allocation of resources and social issues.

According to the above reasoning, separating the aid from the tax will help maintaining the incentive effect as well as the signalling effect of the environmentally justified tax measure, while simultaneously using the proceeds from the tax measure to abrogate for instance competitive disadvantages caused by the tax. I find this logic is fairly convincing, but it does not seem to have been fully endorsed by the EU institutions. Therefore, adopting environmental tax measures which resemble closed systems or other types of measures which canalise aid through private entities may be less attractive than what may first seem to be the case. Regardless of the private nature of such aid measures, they should be notified to make sure that the Commission does not consider there to be State control over the resources distributed.

On a final note, I find it important to point out that adopting of national indirect taxes to promote environmental protection can be rather desirable from the point of view of State aid control, even when combining such measures with tax breaks or exemptions. In other words, indirect taxes can, in my view, be recommended as an instrument of environmental policy. This is so since indirect taxes, which are taxed at the destination, are fairly unlikely to produce harmful tax competition with the exception of areas with extensive consumer mobility. Moreover, the objective of continuous incentives for improving the environment would be difficult to realise with other types of regulation. Therefore, indirect environmental taxes deserve to be further developed. As long as an EU-wide agreement on environmental taxation cannot be reached, the responsibility of introducing taxes lies on the Member States. The on-going project for developing the Environmental Aid Guidelines is therefore an important step to facilitating the adoption of national environmental taxes.